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IN THE

Supreme Court of The United States

Spring Term, 1972

No.

WACHOVIA BANK AND TRUST COMPANY,
Petitioner

v.

R. KENNEDY HARRIS, TRUSTEE OF THE ESTATE OF CABANA CLUB APARTMENTS, INC.,
Respondent

IN THE MATTER OF:

CABANA CLUB APARTMENTS, INC.,
Debtor

PETITION OF WACHOVIA BANK AND TRUST COMPANY FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Petitioner, Wachovia Bank and Trust Company (hereinafter "Wachovia"), petitions the Court to grant a Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit affirming the Order of the District Court for the Middle District of North Carolina approving a plan of reorganization for Cabana Club Apartment, Inc. under Chapter X of the Bankruptcy Act.

OPINIONS BELOW

The Decision of the Court of Appeals, by a divided court, decided February 17, 1972, is reported at 455 F 2d 841, and appears in the Appendix to this Petition at pages A2 - A11. The Memorandum Order of the District Court, entered March 4, 1971, which was not reported, appears in the Appendix (A11 - A12). The Report of the Special Master on Hearing for Approval of the Plan of Reorganization, dated January 29, 1970, which was adopted by the District Court in its Memorandum Order, appears in the Appendix (A13 - A52).

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1972, and this Petition for Certiorari was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether a plan of reorganization which defers payment of amounts due to the senior creditor while immediately paying junior creditors in full violates the requirements and limitations of Chapter X of the Bankruptcy Act?

2. Whether a plan of reorganization which adversely affects the rights of the major creditor, a commercial bank, in fundamentally altering its loan from a short-term construction loan to a long-term 20-year loan in violation of the loan agreements between the parties and banking practices and policies of commercial banks is permissible under Chapter X of the Bankruptcy Act?

3. Whether the type of plan and debtor here involved

qualifies as a corporate reorganization within the purposes and function of Chapter X?

4. Whether a plan and the judicial approval thereof which requires the senior creditor to pay to the debtor and junior creditors a sum of money which it never received and does not have, and otherwise acts in a punitive way toward the senior creditor, complies with the fair and equitable requirements of Chapter X of the Bankruptcy Act?

5. Whether the perfunctory adoption by the District Court of the Report of the Special Master without analyzing the plan or reviewing the detailed objections thereto and exercising its independent judgment concerning the plan, complied with the function and duty of the District Court in Chapter X proceedings?

STATUTES INVOLVED

The case involves the application of the provisions of Chapter X of the Bankruptcy Act (United States Code, Title 11, Chapter 10, sections 501-676). The sections in this Chapter which are particularly pertinent to questions presented are Sections 174, 179, 216 (subparagraphs (1) to (7)), and 221 of the Bankruptcy Act (11 U.S.C. §§ 574, 579, 616, 621, respectively), hereinafter set forth:

> "Sec. 174. After the hearing, as provided in section 169 or section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 172 of this Act, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply with the provisions of section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a

time within which the creditors and stockholders affected thereby may accept the same.

"Sec. 179. After a plan has been accepted in writing, filed in court, by or on behalf of creditors holding two-thirds in amount of the claims filed and allowed of each class, and, if the debtor has not been found to be insolvent, by or on behalf of stockholders holding the majority of stock, of which proofs have been filed and allowed, of each class, exclusive of creditors or stockholders or of any class of them who are not affected by the plan or whose claims or stock are disqualified pursuant to section 203 of this Act, or for whom payment or protection has been provided as prescribed in paragraphs (7) and (8) of section 216 of this Act, the judge shall fix a hearing, upon notice to the debtor, creditors, stockholders, indenture trustees, the Secretary of the Treasury, the Securities and Exchange Commission, and such other persons as the judge may designate, for the consideration of the confirmation of the plan and of such objections as may be made to the confirmation.

"Sec. 216. A plan of reorganization under this chapter—(1) shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise;

(2) may deal with all or any part of the property of the debtor;

(3) shall provide for the payment of all costs and expenses of administration and other allowances which may be approved or made by the judge;

(4) may provide for the rejection of any executory contract except contracts in the public authority;

(5) shall specify what claims, if any, are to be paid in cash in full;

(6) shall specify the creditors or stockholders or any class of them not to be affected by the plan and the provisions, if any, with respect to them;

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan,

(a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or

(b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

* * * *

"Sec. 221. The judge shall confirm a plan if satisfied that—(1) the provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

(3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this Act;

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceedings or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; and

(5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy."

STATEMENT OF THE CASE

1. *Proceedings leading to this Petition*

Cabana Club Apartments, Inc. filed a Petition under Chapter X of the Bankruptcy Act on July 27, 1967. At the outset, Wachovia Bank and Trust Company, which holds 100% of the debts secured by a first lien on Debtor's property and 89% of the total debts of Debtor, filed a Motion to Dismiss, the denial of which was affirmed by the Fourth Circuit on an earlier appeal on the "narrow issue" of whether the Debtor's Petition was filed in good faith in compliance with Chapter X. *Wachovia Bank and Trust Company v. Dameron, Trustee,* 4 Cir., 406 F 2d 803 (decided February 5, 1969). A copy of this Opinion is

included in the Appendix.[1] (A53 - A58)

Subsequently a plan was submitted by the Trustee on July 28, 1969. Objections to the plan were filed by Wachovia (see Section 179 of the Bankruptcy Act, requiring consents of "creditors holding two-thirds in amount of the claims filed and allowed of each class.") The so-called plan of reorganization was approved in a Report filed by the Referee in Bankruptcy sitting as a Special Master. The District Judge in a Memorandum Order entered March 4, 1971, simply adopted the Report of the Referee on the ground that "the Court must accept his findings unless they are clearly erroneous."

On appeal therefrom, a divided Fourth Circuit decided on February 17, 1972, to affirm. The dissenting opinion by Circuit Judge Field takes a sharp issue with the majority decision, adopting the firm position that the plan of reorganization does not comply with the requirements of Chapter X and should not be approved. From the Judgment of affirmance entered by the Fourth Circuit, this Petition for Writ of Certiorari is sought on the grounds that important

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[1] It is very significant that in that earlier appeal, the Fourth Circuit conceded that the rise in the interest rates "foretells a difficulty" in working out a plan, but was unwilling at that time to say that an acceptable plan was "an impossibility." This reference to current interest rates necessarily shows that the court was at that time thinking of a possible refinancing of the project whereby Wachovia would be paid off. In dealing with Wachovia's prediction that the plan likely to be proposed was one deferring payment of its note over the term of 20 years, the Court of Appeals stated: "We do not read the report and the confirming order *so narrowly.*" (Emphasis added) The opinion stressed that the Referee "suggested that Wachovia could be paid in full by arranging other long-term financing." It can thus be seen that the court—far from giving its sanction to the kind of plan which the Trustee has come up with, which involves deferring payment of Wachovia's construction loan over a period of more than 20 years—was thinking in terms of paying Wachovia "in full by arranging other long-term financing."

and far-reaching questions dealing with the function and application of Chapter X of the Federal Bankruptcy Act, as well as the duty and function of a district judge in considering a plan of reorganization, are involved, and that the decision of the Fourth Circuit conflicts with applicable decisions of the Supreme Court, as well as other circuits.

2. *Facts concerning the debtor and the plan of reorganization material to the question here presented*

Debtor is a one-man corporation, owned and managed by Alvin Silverman. Debtor's sole asset and business is the Cabana Club Apartments, an apartment project in Greensboro, North Carolina, which was created in the following manner:

Making a nominal investment himself, Silverman sought to obtain a corporate loan to finance a proposed apartment house project. He secured from Wachovia Bank and Trust Company a commitment for an interim loan to finance construction and, working through Wachovia, secured a commitment from Aetna Life Insurance Company for a long-term loan (sometimes referred to as the "permanent loan") to be used to pay off Wachovia at the completion of construction, which was to take about 9 months. The long-term loan was to be amortized over a period of 20 years. Aetna's commitment was issued October 28, 1965, and Wachovia's commitment was issued March 29, 1966. Several written loan agreements were entered into by Debtor, each explicitly agreeing that Wachovia was putting up the short-term money during construction only and was to be paid off immediately after completion of construction, and Debtor agreed to take the necessary steps to obtain and close a long-term loan from a long-term lending institution for this purpose.

Just prior to commencement of construction a note and

deed of trust in the principal amount of $640,000 were executed, on May 10, 1966, and placed on record; it provided that monthly amortization payments commence April 1, 1967. It was contemplated construction would be completed by this time, whereupon the note and deed of trust were to be assigned by Wachovia to the long-term lender without the necessity of executing and recording a new deed of trust from Debtor to the long-term lender.

Toward the end of construction, in the spring of 1967, after Wachovia had advanced Debtor approximately $632,000 of the $640,000 construction loan commitment, it was discovered that a number of laborers and material suppliers, totalling over $50,000.00, had not been paid by Debtor, in direct violation of the loan agreements. Moreover, because of the existence of the unpaid laborers and material furnishers, who were lienholders or potential lienholders, the title insurance company would not issue a permanent title policy to the long-term lender. Obtaining this title insurance was a fundamental requirement of Aetna Life Insurance Company for closing the long-term loan; and Debtor was unable to come up with title insurance from any source. After exhausting its extensive efforts to get Silverman to come up with the funds to pay off the construction creditors and to arrange for compliance by Debtor with the conditions required to close the permanent loan and thereby repay Wachovia, Wachovia declared a default on the note and deed of trust and accelerated payment of the $632,000 due thereon. Debtor thereupon filed a Chapter X petition.

The so-called plan of reorganization submitted by the Trustee essentially provides (1) that Silverman put up $50,000 to pay in full the unpaid laborers and material furnishers and the 1967 taxes which had never been paid, (2) that the sole asset, the Cabana Club Apartments, be returned to the Debtor and the old management be restored,

and (3) that the payment of the $632,000 construction loan of Wachovia be deferred over a period of at least 20 years.

The undisputed evidence was that Wachovia Bank, the largest bank in North Carolina and in the Southeast, is not in the business of making long-term loans and has never made a long-term "permanent" loan of this kind, that this is against the long-established policy and practice of Wachovia and violates the lending practices of commercial banks, which operate primarily on the basis of demand deposits, and cannot, therefore, properly make loans extending as long as 20 years.

REASONS FOR GRANTING THE WRIT

The basis for seeking a Writ of Certiorari is that the Court of Appeals has incorrectly interpreted and applied Chapter X of the Federal Bankruptcy Act, in conflict with decisions of the Supreme Court and decisions of other Courts of Appeals. The decision below deals with an important question of federal law which will have a far-reaching effect on the use of Chapter X. It will also drastically affect the lending practices and risks of commercial banks and secured creditors for whom the decision below represents a profound change in what had previously been understood to be the rights and risks of the parties.

It is believed, as will be shown in Points 1, 2, and 3, that the decision below conflicts with the decisions of this Court and the other circuits concerning the purpose and application of Chapter X of the Federal Bankruptcy Act to this kind of a situation, but if it is deemed that the questions here raised have not been previously settled, they should by all means be decided at this time. Delineation in this case of limitations on the use of Chapter X to alter and impair the rights of senior creditors and fundamentally

rewrite agreements will be of broad importance to the business community, and will prevent widespread future misuse of Chapter X and the resulting alteration and curtailment of commercial lending and security practices which would follow from the decision below if allowed to stand.

Finally, it is believed, as will be shown in Point 4, that in affirming the manner in which the District Court approached and dealt with the plan of reorganization before it and its perfunctory acceptance of the report of the Referee, without exercising its own independent, analytical, judgment of the plan, the Court of Appeals has so far sanctioned a departure from the accepted and usual course of judicial proceedings in performing the statutory duty of the District Court in considering a Chapter X plan as to call for the exercise of this Court's power of supervision. An amplification of these reasons relied on for the allowance of the Writ as applied to the circumstances of this case is set forth below.

1. Decision of Court of Appeals Approving Plan of Reorganization Violates Chapter X Requirements In Impairing Rights of Senior Creditors While Paying Junior Creditors in Full

The plan of reorganization which has thus far received a judicial seal of approval provides for the immediate, full, and certain payment to the junior creditors but deferred and uncertain payment to the senior creditor. It provides that the Class B and the Class C junior creditors shall be paid in full in cash immediately upon confirmation of the plan whereas the non-accepting senior, Class A, creditor, holding almost 90% of the total debt, is not to be paid in full for at least 20 years. Moreover, the plan fails to make any provision for the immediate payment of the existing arrearage of 13 months of unpaid principal

payments now due Wachovia (see Point 3b, *infra*), even if it were in fact proper to pay Wachovia "according to the terms of the note and deed of trust" as the plan purports—but fails—to do. The result is that junior creditors are receiving immediate full payment of everything owed them *before* any payment of *past due* amounts owed the senior creditor. In addition, the plan changes the entire nature of the short term loan of Wachovia required to be repaid in full at the end of construction in April, 1967, and defers payment over at least 20 years of an obligation already due in full under the express terms of the written loan agreements between Debtor and Wachovia (even apart from the acceleration of the note caused by Debtor's defaults).

In *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414 88 S. Ct. 1157 20 L. Ed. 2d 1 (1968), this Court unequivocably declared:

> "Under §§ 174, 221 (2) of Chapter X, 52 Stat. 891, 897, 11 U.S.C. §§ 574, 621 (2), a bankruptcy court is not to approve or confirm a plan of reorganization unless it is found to be 'fair and equitable.' This standard incorporates the *absolute priority* doctrine under which creditors and stockholders may participate *only in accordance with their respective priorities.* . . . participation by junior interests depends upon the claims of senior interests being *fully* satisfied. . . ."[2]

United States v. Key, 397 U.S. 322, 90 S. Ct. 1049, 25 L. Ed. 2d 340 (1970) recently held that neither Section 216 (7) and 221 nor the special statute applying to Government claims (which was viewed as consistent with the

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[2] Emphasis in this quotation and the others in this Petition has been added.

approach of Chapter X) permit a plan providing for immediate, although partial, payment to junior creditors simultaneously with immediate, partial payment to the senior creditor and deferred payment of the balance of the senior creditor's claim. The Opinion states:

> "This Court has long held that these words, along with the words 'fair and equitable' in § 221, in no way authorize a District Court to ignore or erode priorities otherwise granted by law, . . . In short, the words 'fair and equitable' in Chapter X are terms of art, and no plan can be 'fair and equitable' which compromises the rights of senior creditors in order to protect junior creditors. . . ."

Marine Harbor Properties v. Manufacturer's Trust Co. 317 U.S. 78, 63 S. Ct. 93, 87 L. E. 64 (1942) held:

> "Approval of the petition on the grounds advanced by the District Court could be made only under the composition theory of reorganization, which chap. X, like § 77B, rejected in favor of the *full priority* rule of the Boyd Case . . . . *That rule protects the rights of senior creditors* against dilution either by junior creditors or by equity interests. . . ."

S.E.C. v. Crumpton Builders, Inc., 5 Cir., 337 F 2d 907, (1964), stated that the fair and equitable "rule would require that a plan of reorganization reduce the claims of investors on a strict priority basis; junior interests would have to be scaled down *before* senior interests could be reduced. . ."

The plan under review squarely contravenes this rule in not providing for immediate payment of amounts due the senior creditor while providing for immediate payment in full of junior creditors, and in failing to give adequate

recognition to the priorities and rights as between senior and junior creditors, and as between the creditors and the sole stockholder of the Debtor, to whom the plan proposes to return the sole asset. The majority opinion of the Fourth Circuit misapplies Chapter X and conflicts with the foregoing decisions.[3]

2. The Plan Does Not Accomplish a Legitimate Corporate Reorganization Contemplated by Chapter X

This is not the type of corporate organization for which Chapter X was designed. As stated in *John-Hancock Mutual Insurance Co. v. Casey,* 1 Cir., 141 F 2d 104, *cert. den.* 323 U.S. 713, 65 S. Ct. 39, 89 L. Ed. 574 (1944):

> "Chapter X was intended to be 'unavailable to corporations having simple debt and capital structures whose only purpose in resorting to the organization procedure is to gain by delay temporary advantages for the old management.' Gerdes, Corporate Reorganizations (1938) 52 Harv. L. Rev. 1, 5."

This principle precisely applies to this Debtor—a one-man, real estate holding corporation, owning a single asset—an apartment project, having the simplest kind of capital and debt structure and no public investors; and to this plan—which has accomplished nothing except to give the old management five years' delay in coming up with the money

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[3] In his dissenting opinion in the case at bar (A8-A11), Judge Field aptly stated:

> ". . . It has long been recognized that the words 'fair and equitable' are words of art, and in my opinion any plan that in effect compromises the rights of a senior creditor to accommodate junior creditors does not comport with the statutory standards. *United States v. Key,* 397 U.S. 332 (1969); *Case v. Los Angeles Lumber Co.,* 308 U.S. 106 (1939)."

to pay the unpaid laborers and material furnishers required by the loan agreements to be paid prior to and as a part of completion of construction, as an express and basic condition of the long-term loan.

In *S.E.C. v. American Trailer Rentals Co.,* 379 U.S. 594, 85 S. Ct. 513, 13 L. Ed. 2d 510 (1965), in reversing the District Judge's order in which he "accepted and adopted" the Referee's findings and report, the Supreme Court expressly relied upon an earlier decision in which:

> " . . the Court recognized that "in general . . . the two chapters were specifically devised to afford different procedures, the one [Chapter X] adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other [Chapter XI] to composition of debts of small individual business and corporations with few stockholders . . .' 310 U.S. at 447, 84 L. Ed. at 1299. . .
>
> "'The basic assumption of Chapter X and other acts administered by the Commission is that the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems.' Id. 310 U.S. at 448 - 449, note 6, 84 L. Ed. at 1300."

The *American Trailer Rentals* opinion goes on to say:

> ". . . It seems clear that in enacting Chapter X Congress had the protection of public investors, and not trade creditors, primarily in mind. . . .
>
> "On the other hand, General Stores also makes it clear that even though there may be no public debt materially and directly affected, Chapter X is still the appropriate proceeding where the debtor has widespread

> public stockholders and the protections by Chapter X are required because, for example, there is evidence of management misdeeds for which an accounting might be made, there is a need for new management, or the financial condition of the debtor requires more than a simple composition of its unsecured debts."

Accord: *S.E.C. v. Crumpton Builders, Inc.,* 5 Cir., 337 F 2d 907 (1968). None of these occasions for Chapter X intervention is present. There are no public stockholders or public debt. The plan proposes a return to the same old management. The plan has not even gone so far as to effect a simple composition of the unsecured debts; it merely provides that the junior creditors shall be paid in full and that Debtor should come up with a sum of money to do this.

The net result of this entire costly Chapter X proceeding and the so-called plan which does not reorganize anything has simply been to give the Debtor five years to raise $50,000 to finish paying the construction creditors, which Wachovia tried repeatedly and unsuccessfully to get it to do in the spring of 1967 when these debts became due, in order to meet the requirements for closing the long-term loan from Aetna before Aetna's commitment expired. This is not a legitimate function of a Chapter X plan. *Lincoln-Alliance Bank & Trust Co. v. Dye,* 2 Cir., 115 F 2d 234 (1940) declared that a plan "must certainly contain more than holding him [the mortgagee] off at the mortgagor's convenience. Chapter X, 11 U.S.C.A. § 501, et seq., was not intended merely to give mortgagors a moratorium upon foreclosure." It is apparent that all this debtor has done is to buy more time at the expense of his creditors "solely on the basis of the speculative hopes and wishful thinking of those having nothing to lose and everything to gain if the speculation turns out to be a success." *Caplan v. Anderson,* 5 Cir., 256 F 2d 416 (1958).

In *Arey & Russell Lumber Co. v. American National Bank & Trust Co. of Danville, Virginia,* 4 Cir., 201 F 2d 508 (1953) the debt to the bank was secured by a deed of trust on the borrower's plant, and the bank had advertised for sale under this deed of trust, whereupon the debtor filed a petition for an arrangement under Chapter XII of the Bankruptcy Act, which specifically deals with relief involving real property; this was dismissed because debtor was a corporation. Then the debtor filed a petition under Chapter X. In dismissing the Chapter X proceeding the Court held:

> "The manifest purpose of the filing was to obtain just such an extension of the indebtedness secured by the deed of trust as had been sought in the Chapter XII proceeding and which Congress had seen fit to deny to corporate debtors. Since the entire secured indebtedness was held by a single creditor that had clearly indicated that it would not grant any extension, it was unreasonable to expect that a plan of reorganization could be effected. 11 U.S.C.A. § 546 (3)."

Thus it can be seen that the decision of the majority in the instant case in permitting the use of Chapter X for this situation and purpose, for which it was never intended, conflicts with the uniform holdings of the Supreme Court and the various circuit courts.

3. In Violation of Sections 174, 179, and 216 of the Bankruptcy Act, the Plan Approved by the Courts Below Adversely Affects Rights of the Senior, Majority Creditor

a. *The bank's short-term construction loan has been converted into an entirely different and unprecedented obligation*

In contradiction of the statement in the plan approved by courts below and in the report of the Special Master adopted by the Judge that Wachovia Bank is "not affected by the plan," the proposed plan drastically affects the rights of the bank inasmuch as it converts a temporary construction loan made by the bank into a long-term loan not made by the bank, in flagrant violation of the unquestioned intention and agreement of the parties, and contrary to necessary commercial banking policy. The loan documents which govern the entire financing of the apartment project plainly and repeatedly provide that the bank's loan was only an interim advance during the construction period of less than a year, and not a long-term 20-year loan, which the bank never intended or agreed to make and which it is not in the business of making. The evidence which was undisputed, was that, for very sound reasons, *Wachovia, being a commercial banking institution dependent upon demand deposits, does not, and cannot consistent with sound commercial banking policy and practice, make long-term 20-year loans.*

There can be no doubt, and indeed the Courts below acknowledge that the bank's loan was to provide construction funds only, and that it was intended and agreed that Aetna, not Wachovia, was to provide the permanent financing, and that Debtor would meet the plainly prescribed conditions to accomplish this. As stated in the Dissenting Opinion below, the effect of this plan is to "enlist the services of the court in a Chapter X proceeding to rewrite the entire series of financing agreements to which the debtor was a party, and force Wachovia into the posture of a long-term lender which plainly was not contemplated by the parties."

It was held in *Lincoln-Alliance Bank and Trust Co. v. Dye*, 2 Cir., 115 F 2d 234 (1940), (Judges L. Hand, Swan,

and A. Hand) dealing with Chapter X, that: "the four possibilities left to the debtor in such a case are in fact scarcely more than ways, either of paying off the lien, or of not affecting the substance of the lienor's rights." It cannot be properly said that the substance of the rights of the senior creditor under the loan agreements is not affected by the plan (Sec. 179) or that it "equitably and fairly" protects Wachovia (Sec. 216), inasmuch as the plan admittedly attempts to extend and convert the loan which the senior creditor agreed to make, for the period of construction only, to a fundamentally different kind of loan and risk, lasting for more than 20 years.

It cannot be stressed too strongly how serious and far reaching is the effect of the approval by the courts below of such a result and such a plan upon the present and future lending policies and practices not merely of Wachovia Bank, but of other commercial bank lending institutions. It is because of the major principle involved and the sweeping and disruptive result of the action appealed from that Petitioner has been so assiduous in urging its objections to the basic approach taken in the bankruptcy court below, which it is submitted, violates a basic premise of Chapter X.

b. *Failure to pay Wachovia the principal arrearage*

Even if the bankruptcy court could legally force a conversion of Wachovia's construction loan into a long-term loan, the plan does not even accomplish what it purports to do, i.e., pay Wachovia "in accordance with the tenor of its note secured by a first lien deed of trust."

The note and deed of trust required that the principal be curtailed by equal monthly payments of $4,586.67 beginning April 1, 1967, to be paid in full by March 1, 1987. No payments whatsoever for the months of April, May, June, July, August, and September of 1967 were made by the Debtor. In October, 1967, the court ordered the trustee

to begin paying $4,586.67 to Wachovia each month, as an interim measure, until a plan could be developed, without prejudice to Wachovia's position and rights. The initial interim payments were applied first to the interest in arrears which had been accumulating and was unpaid, with the result that the interim payments made by the trustee under court order in the month of October, 1967 through May, 1968, were applied entirely to unpaid back interest. It was not until June of 1968, *more than a year* after April 1, 1967, when amortization of the principal was required to begin, that any amount was able to be applied to principal. This existing deficit in the loan account has not been made up. The proposed plan makes no provision to pay this principal arrearage, nor are there any funds available to do this.

Wachovia has, therefore, been deprived of 13 back principal payments, and if, in fact, payment had been made to Wachovia "in accordance with the terms and provisions" of the long-term loan, it would have approximately $20,000 more today than it does have, on which it could be earning a return. It is thus manifest that the plan adversely affects the rights of the senior and majority creditor, is not "fair and equitable," and pays junior creditors in full before paying the senior creditor even the amounts past due. Without its consent, therefore, the plan cannot be approved under Chapter X.

As held by the Second Circuit in *In re Murel Holding Corp.*, 2 Cir., 75 F 2d 94 (1935):

> "it is plain that 'adequate protection' must be completely compensatory; and *that payment ten years hence is not generally the equivalent of payment now.* Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will

> scarcely be content with that; he wishes to get his money or at least the property."

The Fourth Circuit itself in *Leas v. Courtney Co.*, 4 Cir., 261 F 2d 13 (1958) ruled that "the secured debt *will be* materially affected" by a proposal *"to extend the time of repayment."*

The erroneous position taken in the decision below is that "Wachovia will, under the plan, be paid in full in twenty years. It has no right to more."[4] This totally misses the point here urged: *Even if* this deficiency and principal arrearage were somehow made over a period of 20 years (even though no provision whatsoever is made for this in the plan) or at the end of the 20-year period by a balloon payment, this will not change the inescapable fact that the lender will have been deprived for many months and years of the existing principal arrearage which is currently past due—which money it would have already received and had the use of, if payments "in accordance with the terms of the note and deed of trust" had been made. This squarely violates the Chapter X rule that "payment ten years hence is not generally the equivalent of payment now" (*In re Murel*, 2 Cir., 75 F 2d 94) and that a plan which will "extend the time of repayment" causes the secured debt

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[4] Likewise, the assertion in the majority opinion that the plan "required that Wachovia be repaid, over a twenty-year period, the total sum of $1,087,040.00, while the principal amount of its loan with 6% interest on the declining balance over a like period would total $1,087,932.00" (which figure, incidentally, came directly from an unsupported statement in respondent's brief and is not to be found anywhere in the record) fails to meet the crucial point made in the text. It also does not add up. By March 1, 1987, when the note and deed of trust require repayment to have been completed, the contemplated continuance of the $4,586.67 monthly payments will have resulted in the payment of only $1,073,280.78 (234 monthly payments x $4,586.67), falling $14,651.00 short of the court's own figure.

to be "materially affected" (*Leas v. Courtney*, 4 Cir., 261 F 2d 13).

c. *Wachovia has been unfairly and unjustifiably ordered to pay to the Debtor a fee which Wachovia did not receive and does not have.*

In the words of Judge Fields in his dissenting opinion, "the ultimate inequity in the plan," and hence in the action of the courts below, is that Wachovia has been ordered to pay to the Debtor (as a necessary part of funding the plan) a commitment fee of $6,400.00 which was paid, not to Wachovia, but to the proposed long-term lender, Aetna Life Insurance Company to cover its expenses, and belongs solely to that company. To force Wachovia to pay such money to Debtor out of its own pocket as a part of the "plan of reorganization" clearly violates the "fair and equitable" requirement of sections 174 and 216. It amounts to an unlawful seizure by the courts. As stated by Judge Fields below: "In my opinion, there is no justifiable basis in law or in fact to summarily tax this item to Wachovia as an incident to the plan."

The majority opinion concedes that this money "was remitted to Aetna" but then rules that "Wachovia should refund the fee so as to make it a resource for payment of all of Cabana's debts." The only attempted justification of this arbitrary action truly smacks of the assessment of a penalty against Wachovia for taking steps to insist upon compliance by the Debtor with the terms of his loan agreement.[5] There is no provision in Chapter X authorizing this

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[5] As stated by the Dissent below:
"The majority repeatedly emphasizes that Wachovia in effect should be penalized for its failure to make a formal tender of the loan to Aetna since under the Buy-and-Sell Agreement Aetna had the option to purchase the loan even though less than all of the con-

kind of punitive action toward a creditor. Can there be any question that the plan is not "fair and equitable" to Wachovia and does "adversely affect" its rights?

4. District Court and Circuit Court Misconstrued the Role of the District Judge in Passing upon Plan of Reorganization Under Chapter X

The Memorandum Order of the District Court states: "In reviewing the findings of fact of the Referee, the court must accept his findings unless they are clearly erroneous . . . it is determined that the findings of fact and conclusions of law of the Referee are neither arbitrary nor clearly erroneous, and the Court adopts the same for the purpose of approving the plan of reorganization submitted by the trustee." Then, without anlayzing or discussing the plan or the findings of the Referee, or considering any of the numerous and detailed objections to the plan and to the findings raised by Wachovia, the District Judge perfunctorily approved the plan. See Memorandum Order in Appendix. (A11 - A12)

TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 88 S. Ct. 1157, 20 L. Ed. 2d 1 (1968) governs this aspect. Reviewing an order of the District Court in a Chapter X proceeding, including findings that certain features of the plan "are fair and equitable," the Supreme Court referred to the

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ditions had been met by the borrower. To seize upon this as the premise for such punitive treatment of Wachovia is utterly unrealistic. In its course of business with Aetna over a long period of years, Wachovia was well aware of the fact that Aetna would not accept the loan with the claims of the materialmen and construction lien holders outstanding and unpaid. Under these circumstances a formal tender of the loan by Wachovia to Aetna would have been a useless act. Certainly it is obvious that if there was any way possible to close the Aetna transaction, Wachovia would have done so and thereby obtained repayment of its construction loan."

"perfunctory, almost offhand manner in which the Court accepted" the recommendations of the trustee, and stated:

> "If the quoted statement of the trial court had been the result of an adequate and intelligent consideration of the merits of the claims, the difficulties of pursuing them, the potential harm to the debtor's estate caused by delay, and the fairness of the terms of settlement, then it would without question have been justifiable to approve the proposed compromises. *It is essential, however, that a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boiler-plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law.*"

The Court emphasized that "it is essential that every important determination in reorganization proceedings receive the 'informed, independent judgment' of the bankruptcy court." The District Court's manner of considering and dealing with the instant Chapter X plan fails to meet the standards plainly set by this Court in *TMT Trailer Ferry*. Indeed it is remarkable how closely the Court came in the quoted passage to describing the order of the District Court here on review.

What Wachovia is attacking is the legality of the proposed plan. The "clearly erroneous" rule does not protect the Referee's approval of a plan (1) which impairs and postpones payments of amounts owing to the senior creditor while paying the junior creditors in full, (2) which adversely affects the rights of the senior, majority creditor without its consent, and is not fair and equitable, and (3) which does not accomplish a legitimate corporate reorganization contemplated by Chapter X.

In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939) after speaking of the District Court's duty in reorganization proceedings to render "an informed, independent judgment" on each important determination, the Supreme Court passed upon "the question of law as to whether on these facts the plan was fair and equitable within the meaning of § 77B [now Chapter X]," and held:

> "on that question of law we think that the District Court erred in confirming the plan and that the Circuit Court of Appeals erred in affirming that decree. We think that as a matter of law the plan was not fair and equitable."

CONCLUSION

For these reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

HUBERT HUMPHREY
Suite 1400, Wachovia Building
Greensboro, North Carolina 27402
Attorney for Wachovia Bank and Trust Company, Petitioner

May 5, 1972

71-1488

MAY 15 1972

MICHAEL RODAK, JR., CLERK

FILE COPY

IN THE

Supreme Court of The United States

SPRING TERM, 1972

No._____

WACHOVIA BANK AND TRUST COMPANY,
Petitioner

vs.

R. KENNEDY HARRIS, TRUSTEE OF THE ESTATE OF CABANA CLUB APARTMENTS, INC.,
Respondent

IN THE MATTER OF:
CABANA CLUB APARTMENTS, INC.,
Debtor

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 71-1441

WACHOVIA BANK AND TRUST COMPANY,
Appellant,

vs.

R. KENNEDY HARRIS, TRUSTEE OF THE ESTATE OF CABANA CLUB APARTMENTS, INC.,
Appellee.

IN THE MATTER OF:

CABANA CLUB APARTMENTS, INC.,
Debtor.

Appeal from the United States District Court
for the Middle District of North Carolina.

This cause came on to be heard on the record from the United States District Court for the Middle District of North Carolina, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

Samuel W. Phillips
CLERK

United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 71-1441

WACHOVIA BANK AND TRUST COMPANY,
Appellant,

versus

R. KENNEDY HARRIS, TRUSTEE OF THE ESTATE OF CABANA CLUB APARTMENTS, INC.,
Appellee.

In the Matter of:

CABANA CLUB APARTMENTS, INC.,
Debtor.

Appeal from the United States District Court for the Middle District of North Carolina, at Greensboro

Eugene A. Gordon, District Judge

(Argued November 4, 1971 Decided February 17, 1972.)

Before WINTER, BUTZNER and FIELD, Circuit Judges.

Hubert Humphrey (McLendon, Brim, Brooks, Pierce and Daniels, on brief) for Appellant, and Arthur O. Cooke (Cooke and Cooke, on brief) for Appellee.

WINTER, Circuit Judge:

When we affirmed the denial of a motion to dismiss the petition for reorganization under Chapter X of the Bankruptcy Act filed by Cabana Club Apartments, Inc. (Cabana), we observed "[a]fter the trustee has presented a plan it will be time enough to consider its merits and legality." Wachovia Bank and Trust Company v. Dameron,

406 F.2d 803, 806 (4 Cir. 1969). That time is now. The trustee has presented a plan which was approved by the referee, as the special master, and later approved by the district court with a slight modification. Notwithstanding the attack of Wachovia Bank and Trust Company, the principal creditor, we affirm.

— I —

The appeal is largely factual but we will be as concise as possible. The basic terms and conditions of the construction loan from Wachovia to Cabana, the commitment of Aetna Life Insurance Company (Aetna) to provide long-term financing, Wachovia's abortive attempt to declare the loan in default and to accelerate payment and the commencement of this Chapter X proceeding are set forth in our prior opinion and need not be repeated here. After we sustained the district court's denial of Wachovia's motion to dismiss the Chapter X petition for lack of good faith (i. e., impossibility of effecting a plan of reorganization), the trustee submitted a proposed plan. Two hearings were held by the referee, who then made detailed findings of fact and recommended that the plan be approved. The district judge conducted a nonevidentiary hearing with regard to Wachovia's objections. He concluded that the referee's findings were not clearly erroneous and he adopted them. He also concluded that the plan was fair, equitable and feasible and that it complied with § 216 of the Bankruptcy Act, U.S.C.A. § 616. In approving the plan, he did so "with express reliance upon the understanding that the note of Wachovia . . . shall be paid in full within the twenty-year period set forth in the note." For practical purposes, the approval, couched as described, had the effect of modifying the plan slightly, in that the plan only required that Wachovia be repaid, over a twenty-year period, the total sum of $1,087,404.00, while the principal amount of its loan

with 6% interest on the declining balance over a like period would total $1,087,932.00. Thus, the district judge effectively required that the additional sum of $891.21, over and above that required by the plan, be repaid within the twenty-year period.

The basic features of the plan are: (1) Cabana's sole stockholder would advance $50,000.00 to Cabana to enable it to pay unpaid construction costs immediately and in full and (2) cash on hand, future income from apartment rentals and a refund, required to be made by Wachovia to Cabana, of $6,400.00 paid to Wachovia to obtain the commitment from Aetna for long-term financing, would be used to pay overdue taxes immediately, and to pay the debt due Wachovia over a twenty-year period and the debt due a second mortgagee over the several year period within which it was due. There was substantial evidence of 95-100% continuous occupancy of Cabana's apartments since they were available for rent.

Overall, Wachovia seeks reversal of the order approving the plan because it contends the plan is not feasible, it does not adequately protect Wachovia's claim, and it improperly alters the terms and conditions of Wachovia's right to repayment, as well as fails to provide for repayment in full. We shall treat these various contentions collectively, stating additional facts only where it is necessary to place the arguments in context.

— II —

Three aspects of the general contention that Wachovia's rights are adversely affected by the plan require discussion. First, it is said that the plan improperly fails to provide for immediate payment of the principal payments for thirteen months in 1967-68, which were due Wachovia under the loan agreement between the parties and the note given by

the debtor, both as amended by subsequent agreement of the parties. It is true that the interest and principal payments for July, August and September were not made when due. Payment of at least the amount due in July, 1967, was, however, tendered by the debtor, but the tender was declined by Wachovia because it was asserting a default and acceleration of the entire loan balance, a position which has been determined to be utterly lacking in merit. Under the plan, these past due principal payments will be fully repaid over the twenty-year period as well as additional principal payments and interest to become due so that, under the circumstances, we see no ground of just complaint. The modification of the plan by the district court to require payment of the additional sum of $891.21 within the twenty-year period answers Wachovia's second argument that it will not be paid in full.

Wachovia's third argument that the plan improperly extends the debtor's obligation to Wachovia over a twenty-year period does not persuade us. Admittedly, Wachovia does not generally make twenty-year loans of the type in this case. And when Wachovia purportedly made a twenty-year loan, it was contemplated by the parties that this would be a construction loan and that when construction was completed, the loan would be offered to Aetna, which was committed to take it if the debtor could offer good and merchantable title, free of mechanics' or materialmen's liens or claims, as security for the loan. But the fact is that Wachovia's subsidiary title company, acting pursuant to the policy of its Chicago principal, refused to guarantee the debtor's title because of unpaid construction claims, notwithstanding that under North Carolina law they did not constitute a prior lien on the property, N.C.G.S. § 44A-10 (1971 Supp.); and Wachovia did not formally tender the loan to Aetna, notwithstanding that Aetna had the option to waive the debtor's payment of all construction costs.

Although the loan agreement provided for Aetna's commitment to provide long-term financing (for which Cabana was required to pay a commitment fee of $6,400.00) and the parties contemplated that the commitment would be availed of when construction was complete, Wachovia's advance was in the form of a twenty-year loan, secured by a deed of trust, with the right of Aetna not to accept the long-term obligation if certain conditions were not met. Having bound itself under these conditions, Wachovia cannot complain that the plan places upon it a more onerous term than that which it selected as the term for the transaction, especially when Wachovia failed to make formal tender of the loan to Aetna. Certainly, the plan does not sufficiently depart from the agreement of the parties with respect to the term of the loan that Wachovia has just cause to complain. Indeed, Wachovia, if it concludes that the loan is in violation of its usual lending policy, may still find another lender to assume the obligation it took on for itself. Even if it does not, its advance is secured by a first lien.

— III —

Wachovia's attack upon the feasibility of the plan is also multi-faceted. First, it is argued that Wachovia should not be required to refund the Aetna $6,400.00 commitment fee, and, subsidiary to this argument, that if the refund is not required, there will be insufficient funds to make the plan workable.

Although it is far from clear that the plan would be unworkable for lack of funds if the $6,400.00 is not refunded so as to make it available for creditors generally, we think that Wachovia should be required to make the refund. As the referee found, and his findings are fully supported by the evidence, Wachovia, Aetna's correspondent, selected Aetna as the prospective long-term lender. Cabana made

no application to Aetna and, indeed, did not even initially know the identity of the "permanent" lender. Wachovia made no commitment to Cabana until the former had obtained a commitment from Aetna; and, as a condition of Wachovia's loan to Cabana, the latter covenanted not to accept permanent financing from any other source. While the commitment fee collected by Wachovia was remitted to Aetna, Wachovia, together with its subsidiary title company, contributed to Aetna's not assuming the loan, and thus contributed to the forfeiture of the commitment fee. In any event, Wachovia acted as agent for Aetna and, since Wachovia alone, by a formal tender of the loan to Aetna, was the only one whose actions may have resulted in a return of the commitment fee by Aetna and it failed to make that tender, equitably, we think that Wachovia should refund the fee so as to make it a resource for payment of all of Cabana's debts.

Wachovia also argues, aside from the commitment fee, that Cabana's present assets, including cash on hand, and prospective rental income, will be insufficient to meet the payments contemplated to be made under the plan. Wachovia seeks to persuade us by constructing schedules of existing and prospective debts and future income to prove capital and income deficiencies. At the outset, we note that Wachovia's figures are suspect by the comparison of cash on hand as of December 31, 1970, with obligations, some of which will accrue later in time and others of which are not recoverable under applicable law, without taking into account rental income actually realized or to be realized in the intervening period. But it suffices to say that the referee and the district judge have found that the plan is economically feasible and we cannot say, after the review of their findings and the evidentiary support for their findings, that they are clearly erroneous. We are satisfied, espe-

cially with the high occupancy rate of the apartments since they have been available, the additional capital contributions to be made and the settlement of some disputed construction cost claims, that the plan is economically feasible.

— IV —

We see no merit in Wachovia's contention that its rights are impaired because some more junior creditors will be paid in full immediately, or prior to full payment to Wachovia. Wachovia will, under the plan, be paid in full in twenty years. It has no right to more.

In its first appeal, Wachovia argued that this is not a proper Chapter X proceeding because Cabana has no public stockholders and no public debt. We consider the point impliedly decided adversely to Wachovia in the first appeal, and we decline to reconsider it.

Finally, we find utterly lacking in merit Wachovia's argument that the district judge approved the plan without sufficient consideration. Of course, the district judge was not bound to adopt the referee's report. In fact, he modified the proposed order in the one respect in which it was deficient. But the record is clear that the district judge gave full, conscientious consideration to Wachovia's numerous meritless objections. When the referee made eighty-seven paragraphs of detailed findings, there was no occasion for the district judge to prepare another complex and detailed opinion when he found that the referee was correct in almost all that he did.

AFFIRMED.

FIELD, Circuit Judge, dissenting:

Even if we assume the feasibility of the plan confirmed by the District Court and countenanced by the majority, it

falls short of being fair and equitable as required by Sections 216 and 221 of the Bankruptcy Act, 11 U.S.C.A. §§ 616 and 621. It has long been recognized that the words "fair and equitable" are words of art, and in my opinion any plan that in effect compromises the rights of a senior creditor to accommodate junior creditors does not comport with the statutory standards. *United States v. Key*, 397 U. S. 322 (1969); *Case v. Los Angeles Lumber Co.*, 308 U. S. 106 (1939).

It runs counter to my judicial grain to see Mr. Silverman, the sole stockholder of Cabana, with an investment of only $400.00 equity capital in the debtor corporation, enlist the services of the court in a Chapter X proceeding to rewrite the entire series of financing agreements to which the debtor was a party, and force Wachovia into the posture of a long-term lender which plainly was not contemplated by the parties and from which, understandably, Wachovia desires to extricate itself.

It is manifestly clear that the debtor was well aware of the fact that Wachovia was to provide only an interim construction loan and that the long-term financing was to come from Aetna and was contingent upon the debtor's fulfillment of the various conditions incident to the Aetna loan. The Consent to Corporate Action by the debtor corporation demonstrates that Mr. Silverman and his wife, as sole directors of the debtor, fully understood this arrangement. The Buy-and-Sell Agreement was clearly a tripartite agreement between Wachovia, Aetna and the debtor corporation, and it is inconceivable to me that Silverman, who executed this agreement on behalf of the debtor did not fully appreciate the financi[illegible] arrangements set forth therein. As a matter of fact, in hi[illegible]stimony before the Referee, Silverman acknowledged th[illegible]he was well aware of Aetna's posture in the financing [illegible]attern. The first condition specified

in the Buy-and-Sell Agreement required that the debtor would complete the apartment project on or before February 15, 1967" * * * free of mechanics' or materialmen's liens or claims * * *." It is undisputed that the debtor failed to meet this requirement and that construction claims in the aggregate of $52,000.00 were outstanding and unpaid on the operative date of the agreement and were still in default at the time the debtor's petition was filed in the District Court.

The majority repeatedly emphasizes that Wachovia in effect should be penalized for its failure to make a formal tender of the loan to Aetna since under the Buy-and-Sell Agreement Aetna had the option to purchase the loan even though less than all of the conditions had been met by the borrower. To seize upon this as the premise for such punitive treatment of Wachovia is utterly unrealistic. In its course of business with Aetna over a long period of years, Wachovia was well aware of the fact that Aetna would not accept the loan with the claims of the materialmen and construction lien holders outstanding and unpaid. Under these circumstances a formal tender of the loan by Wachovia to Aetna would have been a useless act. Certainly it is obvious that if there was any way possible to close the Aetna transaction, Wachovia would have done so and thereby obtained repayment of its construction loan. The ultimate inequity in the plan is the inclusion of the $6400.00 Aetna standby fee as a receivable from Wachovia. This amount was paid by Cabana to Aetna as earnest money on the loan commitment and was, of course, retained by Aetna when the permanent loan arrangement aborted as the result of the debtor's default in meeting the agreed conditions. In my opinion there is no justifiable basis in law or in fact to summarily tax this item to Wachovia as an incident to the plan.

Mr. Silverman was no naive babe-in-the-woods in his

dealings with Wachovia and Aetna. From his own testimony before the Referee it would appear that he had engaged in several disastrous ventures of this type in Florida before coming to North Carolina and left a considerable number of disenchanted and frustrated creditors in his wake. The plight of the debtor corporation in the present case was the direct result of its failure to live up to the plain terms of its agreements with Wachovia and Aetna. The plan approved in this case may not be fair and equitable to Wachovia but it is assuredly a judicial windfall for Mr. Silverman.

I would reverse.

MEMORANDUM ORDER

GORDON, District Judge

This matter is presently before the Court under the provisions of Section 174 of the Bankruptcy Act (11 U.S.C. § 574) for the approval of the Plan of Reorganization submitted by the Trustee, R. Kennedy Harris. Wachovia Bank and Trust Company, secured creditor of the debtor corporation, has filed numerous objections to the findings of fact, conclusions of law and recommendations of the Honorable Rufus Reynolds, Referee in Bankruptcy.

In reviewing the findings of fact of the Referee, the Court must accept his findings unless such are clearly erroneous. General Orders in Bankruptcy No. 47; *Mountain Trust Bank v. Shifflett*, 4 Cir., 255 F. 2d 718 (1958); *Austin v. National Discount Corporation*, 4 Cir., 322 F. 2d 928 (1963). After hearing oral arguments and considering the entire official file, including transcripts, exhibits and briefs

of counsel, it is determined that the findings of fact and conclusions of law of the Referee are neither arbitrary nor clearly erroneous, and the Court adopts the same for the purposes of approving the Plan of Reorganization submitted by the Trustee.

The Court further determines that the Plan of Reorganization as submitted by the Trustee is fair and equitable, and feasible, and also finds that the Plan of Reorganization is in compliance with Section 216 of the Bankruptcy Act (11 U.S.C. § 616). The approval of the Plan of Reorganization by the Court is made in express reliance upon the understanding that the note of Wachovia Bank and Trust Company shall be paid in full within the twenty-year period set out in the note.

IT IS ORDERED that the findings of fact and conclusion of law be, and the same hereby are, made the findings and conclusions of the Court.

IT IS FURTHER ORDERED that the Plan of Reorganization filed by R. Kennedy Harris, Trustee, be, and the same hereby is, approved.

IT IS FURTHER ORDERED that the Trustee comply with the provisions of Section 175 of the Bankruptcy Act (11 U.S.C. § 575) in respect to the submission of information to creditors and stockholders.

IT IS FURTHER ORDERED that the creditors and stockholders affected by the Plan of Reorganization shall have sixty days from the date of this Order in which to accept the same.

/S/Eugene A. Gordon
Eugene A. Gordon
United States District Judge

March 4, 1971

REPORT OF SPECIAL MASTER ON HEARING FOR APPROVAL OF PLAN OF REORGANIZATION

THE ISSUES FOR DETERMINATION arise upon the hearing on a Plan of Reorganization filed herein by R. Kennedy Harris, Trustee of Cabana Club Apartments, Inc., on July 28, 1969.

Pursuant to Sec. 169 of the Bankruptcy Act, the Trustee was directed by the Court to file a Plan of Reorganization on or before July 28, 1969, or in the alternative to file a report stating his reasons why a Plan of Reorganization could not be effected. A proposed Plan (copy of which is attached) was filed on said date.

Notice of the filing of said Plan of Reorganization, together with a copy of the Plan, was sent to all creditors, stockholders, and other parties in interest on October 6, 1969, said notice also designating the time, place, and date for hearing on the proposed Plan.

THIS MATTER CAME ON FOR HEARING and was heard on November 14 and December 5, 1969, before the undersigned Referee in Bankruptcy for the United States District Court for the Middle District of North Carolina, as Special Master, upon the Plan of Reorganization submitted by R. Kennedy Harris, Trustee, and the Court having heard and considered all of the evidence, including the evidence and exhibits heretofore presented in connection with the original Motion to Dismiss filed by Wachovia Bank and Trust Company (See *Wachovia Bank and Trust Company v. Dameron,* 4th Cir., 406 F (2d) 803, 1969), as well as additional evidence and exhibits presented and filed at hearings on the proposed Plan of Reorganization, and having carefully considered and examined said Plan in

all its respects, and considered objections thereto filed by Wachovia, and reviewed the applicable law, makes the following Findings of Fact, Conclusions of Law, and Recommendations:

FINDINGS OF FACT

1. Debtor, Cabana Club Apartments, Inc., is a North Carolina corporation, with its principal office and place of business in the City of Greensboro, North Carolina. It was originally chartered under the name of Point Homes, Inc., and subsequently its corporate name was changed to Cabana Club Apartments, Inc.

2. Alvin Silverman is now, and since its incorporation, has been president of Cabana Club Apartments, Inc. The corporation had a capitalization of $400.00 derived from the sale of its shares of stock, all of which is owned by Silverman. There are no other stockholders of the corporation.

3. Debtor's sole asset consists of a five (5) unit apartment complex (See Finding of Fact No. 55), constructed during the period May 14, 1966 - May 17, 1967. The land upon which the project was constructed was acquired by Debtor from Kavanagh-Smith & Company which agreed to subordinate its purchase money deed of trust, securing Debtor's installment payment note in the principal amount of $33,000.00, to a first lien deed of trust held by Wachovia Bank and Trust Company, securing Debtor's note in the principal amount of $640,000.00. During the period of construction, Wachovia advanced on its loan approximately $632,500.00 to defray the costs of materials and labor.

4. On July 27, 1967, Debtor, Cabana Club Apartments, Inc., filed its petition pursuant to the provisions of Chapter

X of the Bankruptcy Act, requesting the appointment of a Trustee to operate the business and manage Debtor's property.

5. Debtor's petition was filed only after Wachovia undertook to foreclose its first lien deed of trust, declaring the note secured thereby in default on several grounds. Debtor contended no default existed and sought an order restraining the foreclosure. (See Findings of Fact Nos. 46, 48, 49, 51, and 53.)

6. On July 27, 1967, an order was entered by the Honorable Edwin M. Stanley, Chief Judge for the United States District Court for the Middle District of North Carolina, restraining the foreclosure and appointing Charles E. Dameron, III, as Trustee. On October 23, 1968, R. Kennedy Harris was appointed Trustee to succeed Mr. Dameron who resigned, and this appointment was duly confirmed on November 29, 1968.

7. At the time Debtor's petition was filed, Debtor was not insolvent, but was unable to pay its debts incurred in construction costs of approximately $50,000.00. Wachovia had declined to advance the remainder of its loan and also refused to return the $6,400.00 commitment fee paid by Debtor. (Finding of Fact No. 50) Debtor's efforts to secure funds to pay these debts were thwarted when Kavanagh-Smith & Company, holder of a second purchase money mortgage in the original amount of $33,000.00 declined to subordinate to the $50,000.00 loan which was available. (See Finding of Fact No. 52).

8. Although forced to operate almost from its completion under supervision of the Court appointed Trustee, Debtor's apartment project has been unusually successful in producing income by reason of a very high average rate of occupancy, generally between 95%-100%. All indications are

that it will continue as a successful business enterprise. (Findings of Fact Nos. 55 and 72).

9. On August 23, 1967, Wachovia Bank and Trust Company filed its Motion to Dismiss Debtor's petition, which motion was denied by the undersigned as Special Master after lengthy hearings. The order denying said motion was affirmed by United States District Court Judge Eugene A. Gordon, and upon appeal affirmed by the Fourth Circuit Court of Appeals. (*Wachovia Bank and Trust Company v. Dameron, Trustee,* 4th Cir., 406 F (2d) 803, 1969).

10. Wachovia's loan commitment, made in 1965, provided for payment of interest at the rate of six per cent (6%). During the period of construction (May 1966-May 1967), the market rate of interest for this type of loan increased to 7%-7¼%. (Finding of Fact No. 42). Since the appointment of the Trustee, this rate has increased to 9½-10%, with other benefits to the lender. (See Finding of Fact No. 64).

11. By reason of the 6% interest rate and the substantial amount of Wachovia's original commitment and loan to Debtor, it is not possible on the present-day money market for the Trustee to secure a loan, permanent or otherwise, sufficient to pay off the Wachovia loan in full ($602,223.08 as of December 1, 1969). The rate of interest on such a loan and other requirements of any such lender, even if available, would preclude the successful operation of Debtor's project.

12. Forced liquidation of Debtor's assets, even at the time of the attempted foreclosure by Wachovia in 1967, and certainly on the present state of the money market would undoubtedly result in no funds being available for payment of unsecured creditors' claims and would extinguish all stockholder equity in the Debtor corporation.

13. The Trustee's Plan in essence provides:

(a) Payment to Wachovia Bank and Trust Company of the balance due ($602,223.08 as of December 1, 1969) on its $640,000 note in monthly installments of $4,586.67, which payments are in exact accord with the provisions for repayment set forth in said note. Continuous, successive monthly payments in this amount have been made by the Trustee throughout the administration of the Chapter X proceeding. Wachovia's deed of trust securing said note will continue as a *first lien* on the property therein described. There is no indication that these payments cannot be made without difficulty from revenues derived from the operation of Debtor's apartment project.

(b) Payment to Kavanagh-Smith & Company of the balance due ($18,610.14 as of November, 1969) on its $33,000.00 note in monthly installments of $482.10, which payments are in exact accord with the provisions for curtailment set forth in said note. Continuous, successive monthly payments in this amount have been made by the Trustee throughout the administration of the Chapter X proceeding. Kavanagh-Smith & Company's deed of trust securing said note will continue, as it has been since its execution, as a *second* lien on the property therein described. There is no indication that these payments cannot be made without difficulty from revenues derived from the operation of Debtor's apartment project.

(c) All persons filing claims for furnishing material or labor in connection with Debtor's apartment project (a total of 13 such claimants, with claims aggregating $51,948.31) would be paid the full amount of their claims.

(d) Capital stock of the Debtor corporation would be increased from $400.00 now outstanding to $71,400.00 by capitalizing stockholder's loan of $21,000.00 made to the

corporation at the time the Wachovia loan was made and by the issuance of shares to the present stockholder for the sum of $50,000.00 to be paid into the corporation and used by the Trustee to carry out the proposed Plan of Reorganization. The sum of $50,000.00 is evidenced by a letter of credit and its availability is contingent upon the ultimate approval of the Trustee's Plan.

(e) Additional funds of $25,140.00 (as of November 14, 1969) are held by the Trustee, which, together with the $6,400.00 commitment fee due Debtor from Wachovia, (Finding of Fact No. 14), creates a total of $31,540.00. Total cash available under the proposed Plan is in the amount of $81,540.00. The total of all claims, all taxes, including 1969 ad valorem taxes in the amount of $14,845.56, and all estimated costs of administration is $77,787.20. Payment of these claims, taxes, and costs of administration will leave Cabana Club Apartments, Inc., free of all debt except the two secured creditors and such minor operating expense as is incurred routinely, all of which such expense can be defrayed from current income.

14. The sum of $6,400.00 paid by Debtor corporation to Wachovia as a commitment fee should be returned to Debtor as provided in the agreement relating thereto, in view of the treatment accorded Wachovia's secured claim by the Plan.

15. Through close communication between Debtor and the relatively few unsecured creditors, it is evident that the provisions of the Plan providing for payment in full of such claims would benefit such creditors, and it is further evident that if the proposed Plan is not adopted no payment will be made to this class of creditors.

16. The proposed Plan is the only method available which will, under the circumstances of this case as reflected by the

Findings of Fact above and hereinafter set forth, equitably and fairly provide adequate protection for the realization by all creditors, both secured and unsecured, of the value of their claims against the property dealt with by the Plan and affected by such claims.

17. Notwithstanding the objections of Wachovia to the approval of the proposed Plan of the Trustee, all of the equities of this case, as disclosed by the Findings of Fact, justify both the Trustee and the Court in declining to pursue a course of forced liquidation in order to attempt to pay Wachovia the balance of its loan forthwith, and that part of the Plan which provides for payment of Wachovia's note in precise and exact accordance with its terms and leaving its first lien deed of trust, securing said note unimpaired as to its seniority, is, under the circumstances of this case, a method which equitably and fairly provides adequate protection for the realization by Wachovia of the full value of its claim against the property dealt with by the Plan and affected by its claim, all of which is in accordance with the provisions of Sec. 216(7) of the Bankruptcy Act (11 USCA 616(7).

18. American Colonial Homes, Inc., is a North Carolina corporation, with its principal office in the City of Greensboro, North Carolina. Alvin Silverman was and is President of said corporation and owner of all of its outstanding shares of capital stock. Said corporation was general contractor for the construction of the apartment project hereinafter referred to.

19. Prior to October, 1965, Silverman, on behalf of Debtor, undertook to secure financing for the construction of the apartment project upon a tract of land on which Debtor had acquired an option to purchase from Kavanagh-Smith & Company.

20. Wachovia Bank and Trust Company is a banking

corporation, organized and existing under the laws of the State of North Carolina. It is one of the largest banking institutions in the southeastern states.

21. After loan application was filed by Debtor, Wachovia obtained credit reports on its President, Alvin Silverman, prior to issuing any loan commitment to Debtor. Silverman explained in writing to Wachovia his connection with certain prior business ventures in Florida which were questioned by Wachovia.

22. Debtor filed application with Wachovia in September, 1965, for a loan of $640,000.00 for the purpose of securing funds with which to construct the apartment project.

23. At the time Debtor's application was filed, Wachovia was correspondent for several large life insurance companies, including, among others, Aetna Life Insurance Company (herein designated Aetna). As such correspondent, Wachovia made arrangements with Aetna for the purchase by it of the long-term installment payment promissory note to be acquired by Wachovia in connection with its contemplated loan of $640,000.00 to Debtor. Debtor did not apply to Aetna for a loan and did not know at the time its application was filed with Wachovia who the so-called "permanent" lender would be. The selection of the "permanent" lender, Aetna, was made by Wachovia pursuant to a Correspondent's Agreement which existed between Wachovia and Aetna. The relationship of Wachovia as correspondent for Aetna exists at the present time. A commitment fee of $6,400.00 was paid by Debtor to Wachovia at the time its application was filed.

24. Upon Debtor's application to Wachovia, Aetna issued a letter of commitment dated October 28, 1965, approving the loan of $640,000.00 to Debtor for the purpose of constructing a five-building, eighty-unit apartment project.

25. Thereafter, Wachovia issued its letter of commitment to Debtor on March 29, 1966, wherein a loan to Debtor in the amount of $640,000.00 was confirmed, subject to Debtor's securing a "standby" loan of $100,000.00, to be used if the Wachovia-Aetna loan closed at $540,000.00 instead of $640,000.00. The sum of $540,000.00 was to be the maximum loan unless certain occupancy requirements by certain dates were met in the rental of units in the apartment project.

26. Debtor secured the required "standby" loan from James Talcott, Inc. No funds were ever advanced to Debtor by James Talcott, Inc., and Debtor has no obligation to this lender. Wachovia advanced funds on its loan in excess of $540,000.00 (actually approximately $632,500.00) and at no time required the "standby" loan to be funded.

27. Before commitment letters were issued, the plans and specifications for Debtor's apartment project were submitted to Wachovia and by it to Aetna. These plans were modified by Aetna to require the addition of cabanas adjacent the swimming pool and were approved in all respects by both Aetna and Wachovia.

28. Debtor had no direct contact with Aetna during the period the loan application was pending and Aetna was selected by Wachovia as the so-called "permanent" lender. Debtor agreed to the participation by Aetna in the loan for which it applied.

29. Some delay was occasioned in connection with the preparation of the necessary documents for closing the loan and it was not until May 13, 1966, that the loan was closed and the executed documents necessary thereto were delivered and/or recorded.

30. One of the requirements of Wachovia in connection with the loan was the furnishing to it of a title insurance policy, insuring that the lien created by Debtor's executed

and recorded deed of trust to Archie C. Walker, Trustee, and Wachovia, securing payment of Debtor's promissory note in the principal amount $640,000.00 was a first lien on the property therein described, the same being the tract upon which the apartment project was thereafter constructed.

31. A policy of title insurance was issued by Chicago Title Insurance Company, through its agent and broker, North Carolina Title Company, of which Archie C. Walker was President. A premium of approximately $1,800.00 was paid by Debtor for the issuance of this policy and this sum represented payment in full of all premiums due on said policy. North Carolina Title Company is a subsidiary or affiliated with Wachovia and received 50% of the $1,800.00 premium for its services as broker and agent for the issuing company. Archie C. Walker was at this time a full-time employee and officer of Wachovia.

32. At the time the loan to Debtor was closed on May 13, 1966, all requirements of the lenders, Wachovia and Aetna, were fully complied with by Debtor. Included was the execution and delivery of Debtor's note (on Wachovia form) in the principal amount of $640,000.00 payable in equal monthly installments of $4,586.67, commencing on April 1, 1967; deed of trust to Archie C. Walker, Trustee, and Wachovia Bank and Trust Company executed by Debtor to secure payment of said note; a promissory note and deed of trust securing "standby" loan from James Talcott, Inc., deed from Kavanagh-Smith & Company conveying to Debtor the property on which construction of the apartments was to be performed; purchase money note in principal amount of $33,000.00 to Kavanagh-Smith & Company, payable in monthly installments of $482.10, representing balance of the $45,000.00 purchase price of the land; deed of trust securing payment of said note; Building-Loan-

Agreement executed between Debtor and Wachovia (Exhibit No. 10); Buy-and-Sell Agreement, executed between Wachovia, Aetna, and Debtor (Exhibit No. 11); construction contract between Debtor and American Colonial Homes, Inc. (Exhibit No. 12); title insurance binder (Exhibit No. 13A); affidavits indicating no work had been performed or materials furnished on the apartment project prior to May 13, 1966 (Exhibit No. 13B); and title insurance policy designating Wachovia as the insured in respect to the first lien created by recordation of its deed of trust on May 13, 1966 (Exhibit No. 13B).

33. Prior to recordation of the loan documents on May 13, 1966, including the deed of trust to Wachovia no materials had been furnished and no labor performed in connection with the construction of the apartment project by Debtor.

34. The procedure utilized by Wachovia and Aetna in connection with the loan is a relatively new method of lending where the funds loaned are to be used for construction purposes. Wachovia follows this procedure for the reason it offers more protection to the lender, eliminates the necessity for execution of a new note and deed of trust by borrower when construction is completed and provides for issuance of a completed title policy, in lieu of a binder, prior to commencement of construction. This method of closing contemplated the assignment to Aetna, without recourse, of the Debtor's note to Wachovia upon completion of construction, and an endorsement of the title insurance policy to change the named insured from Wachovia to Aetna. No new note or deed of trust or note was to be executed by Debtor.

35. Construction of the apartment project was commenced by American Colonial Homes, Inc., as general contractor, within a few days after May 13, 1966. Alvin

Silverman personally supervised all construction and was on the job site daily, as his full-time occupation, from commencement of construction until completion.

36. Wright Homes, Inc., with whom American Colonial Homes, Inc., had a contract in the amount of approximately $187,000.00 to furnish frame components, all structural members, dry wall, windows, doors, and finish material became insolvent shortly after construction commenced. Arrangements were made for Wright Homes, Inc., to undertake completion, to the extent possible, of the contract, under supervision of the bankruptcy court. This resulted in substantial delay in the construction of the project.

37. Nothwithstanding the delay occasioned by the failure of Wright Homes, Inc., to deliver material as scheduled, the first of the five apartment units (Building A) was completed in November, 1966, and rental of apartments in this unit was begun immediately upon completion.

38. During the course of construction, at monthly intervals, disbursements were made by Wachovia based on a schedule of work completed and unpaid obligations arising therefrom, each schedule approved by the architect. At the time of each such disbursement an inspection was made of the job site and the progress of construction by an official of Wachovia.

39. An extension of the completion date of the project as contemplated by the commitment letters was agreed upon by the parties shortly after the loan was closed on May 13, 1966, because of the delay encountered in the initial closing and the consequent delay in the commencement of construction. Thereafter, a second extension of the completion date was agreed upon whereby May 30, 1967, was fixed as the completion date and the date upon which Wachovia would assign Debtor's note to Aetna.

40. In accord with the extensions set forth in Finding of

Fact No. 39, the payment provisions of Debtor's note to Wachovia were extended by agreement so as to require the first monthly installment payment of principal and interest to be made on July 1, 1967. Debtor paid monthly installments of interest to Wachovia each month on the amount of funds theretofore disbursed, including interest payments in excess of $3,000.00 per month for the months of April, May, and June, 1967. At no time during this period did Wachovia demand monthly payment of both principal and interest, but, on the contrary, accepted and retained each monthly payment of interest.

41. On April 14, 1967, Mr. Miller of Wachovia, along with other personnel from Wachovia, inspected the construction which had been progressed to the final stages of completion and at which time numerous apartments in the finished buildings were occupied. At this time, neither Wachovia nor Aetna was aware that the balance of the undisbursed loan funds would not be sufficient to pay all costs of construction. Nonetheless, Silverman was advised on this occasion that Wachovia did not intend to "close" the loan by assigning it to Aetna because of the quality of construction. Miller told Silverman that Debtor should seek a new loan from an independent source and pay off Debtor's loan from Wachovia. Other than one criticism relating to the first building, which was corrected by the builder, this was the first indication by Wachovia of any dissatisfaction with the quality of construction. Silverman stated to Wachovia's representative that there was no basis for their complaint relating to the quality of construction, and that he expected both Wachovia and Aetna to honor the loan commitment.

42. On the occasion referred to in Finding of Fact No. 41, the money market was such that interest rates for loans of this character had increased from 6% when the Wacho-

via-Aetna commitments were made to a minimum of 6¾% to 7¼%. This fact was known to Silverman. Upon advice of Debtor's attorney, Silverman contacted a recognized lending institution (Cameron-Brown Co.) to determine the availability of a $640,000.00 loan, and confirmed the fact that such a loan would require an interest rate of 7%. This was done by Debtor on the advice of counsel and for the sole purpose of establishing an element of damage to Debtor in the event Wachovia and Aetna failed to complete the loan commitment as agreed. The prospect of a new loan was not pursued further by Debtor.

43. Construction of the five-unit apartment project was completed on May 17, 1967. At this time, over 80% of the apartments were rented. The City of Greensboro issued a letter on that date confirming that the apartment units met all City building codes and regulations and all zoning requirements. Said apartment project was constructed in accordance with the plans and specifications therefor.

44. On May 12, 1967, Wachovia forwarded to counsel for Debtor a detailed list of ten items (Exhibit No. 18) which it stated would be required by it prior to the transfer and assignment of the $640,000.00 note to Aetna. These ten items are as set forth in said Exhibit No. 18.

45. Thereafter, Wachovia further demanded lien releases be obtained from all persons, firms, and corporations who had not been paid for labor and/or materials furnished in the construction of the apartment project and furnished Debtor with forms to secure such lien releases. The purpose of these releases was to have each such claim or lien expressly declared to be subordinate to the lien of Wachovia's deed of trust. Debtor advised Wachovia that its lien was superior to any possible claim or lien and that such lien releases could have no effect other than confirm the existing status.

46. On May 30, 1967, Debtor had complied or was in a position to comply with each of the conditions set forth in Wachovia's letter of May 12, 1967 (Exhibit No. 18) except that the chattel mortgage which Wachovia demanded as one of the conditions to releasing the remainder of the loan proceeds and returning the $6,400.00 commitment fee could not then be certified as a first lien chattel mortgage.

47. Nothing in any of the documents relating to the entire transaction involving Wachovia, Aetna, and Debtor, nor any agreement between said parties, provided that Debtor should furnish a *first* lien chattel mortgage as a condition to Wachovia's assignment of the loan documents to Aetna. The first request for such instrument was made in the letter of Wachovia of May 12, 1967, (Exhibit No. 18). Nonetheless, this is one of the grounds upon which Wachovia contends the loan in default.

48. On May 30, 1967, when Debtor's attorney notified Wachovia that all requirements set forth in Wachovia's letter of May 12, 1967, were complied with (Finding of Fact 46) and all documents requiring recordation were ready for recordation, Wachovia advised that it was calling Debtor's loan and demanding payment in full of the amount advanced to Debtor (approximately $632,500.00) on its $640,000.00 note, contending the loan was in default.

49. Debtor's attorney, upon Alvin Silverman's instructions, immediately wrote to Wachovia and set forth Debtor's position that the loan was not in default.

50. On May 30, 1967, Wachovia held approximately $7,200.00 of undisbursed loan proceeds, and Wachovia and Aetna retained the $6,400.00 commitment fee which had been paid at the time Debtor's application was filed. If Wachovia had not called the loan, more than $13,600.00 would have been available to Debtor for its use in payment of unsecured obligations arising from construction costs. The

undisbursed loan proceeds are still held by Wachovia, and the $6,400.00 commitment fee has not been returned to Debtor. The proposed Plan requires the return of this fee to Debtor in view of the disposition made in said Plan for the continued payment of Wachovia's note in accordance with its terms. (Finding of Fact No. 14).

51. There was no default in any payment due on Debtor's note of May 13, 1966, to Wachovia. An agreement existed between Wachovia-Aetna and Debtor which extended the time for the first monthly installment curtailment payment to be made until July 1, 1967. Wachovia had accepted monthly payments of interest on the loan funds theretofore advanced for the months of April, May, and June, 1967, and made no demand for any further payment in any of said months. Debtor mailed its check in the amount of $4,586.67 to Wachovia on July 1, 1967, as payment on its note, but Wachovia refused to accept payment and returned the check to Debtor.

52. Thereafter, Debtor secured a loan of $50,000.00, which would have cost Debtor $15,000.00, from James Talcott, Inc., of New York, New York, conditioned upon such loan being secured by a second lien deed of trust on Debtor's property. Debtor anticipated using the proceeds of this loan to the extent necessary to pay off all unpaid obligations arising from the construction of the apartment project. However, Kavanagh-Smith & Company declined to agree to subordinate its second lien purchase money deed of trust to the Talcott loan and for this reason only the Talcott loan funds were never made available to Debtor.

53. No substantial reason existed on May 30, 1967, for Wachovia and Aetna to decline to carry out the assignment of the note as contemplated by the agreement between the parties. There was no default in payment (this contention was made by Wachovia for the first time on May 30, 1967).

Wachovia did undertake to assign other reasons for its action in declaring Debtor's loan in default. None of the reasons assigned by Wachovia justify it for declaring Debtor in default on the note and demanding payment in full of the loan.

54. Debtor's apartment project was completed on May 17, 1967, in accordance with the plans and specifications therefor which had been reviewed, modified, and approved by Wachovia and Aetna prior to commencement of construction. On said date almost every apartment was leased, and shortly thereafter, Debtor's apartment project was 100% rented. Each tenant executed lease agreements for one-year terms, with a security deposit of $125.00 paid upon the execution of the lease, to be forfeited in the event tenant did not carry out the terms of the lease. Since that date, rental has been increased to $135.00 per month for new tenants.

55. The apartment project constructed by Debtor is more successful from every standpoint than could have been reasonably anticipated. All eighty of its apartments are rented substantially all the time, producing a gross monthly income of approximately $10,000.00, or approximately $120,000.00 per year. It consists of five two-story, brick veneer buildings, with sixteen apartment units in each building. All apartments are individually electrically air conditioned and heated. Carpeting, refrigerator, disposal, dishwasher, oven-range, and cabinets are furnished. Paved parking facilities of one and one-half spaces per apartment are provided. In addition to the apartments, there is a complete recreational facility with pool, half of a basketball court, badminton, shuffleboard. Individual cabana units for each apartment front on the pool. There is a large room and laundry facility. Dishwashers, drapery rods at all sliding doors and windows and visual dividers between upper-level balconies

were included in the finished construction although the plans and specifications did not include these items. The apartments are now and have been substantially 100% occupied since mid-summer, 1967, even though operated by the Trustee under Court supervision. The prospects of a continuation of very substantial occupancy for the future are good. The demand for apartments has resulted in an increase in monthly rental from $125.00 to $135.00 for leases now being executed.

56. If payment of all secured indebtedness is made in accordance with the terms thereof (Wachovia-Aetna loan at $4,586.67 per month and Kavanagh-Smith & Company at $482.10 per month) and payment of all operating expense, including manager's salary, utilities, and maintenance is made, and a reserve established for all ad valorem taxes and insurance, the operation of Debtor's apartments would annually reflect a substantial profit.

57. The collateral security for which Wachovia and Aetna contracted is the maximum that could possibly have been anticipated. The contentions of Wachovia that the project is located near a major highway; that it would depreciate in value over the years are wholly without merit, as all of this was well known to Wachovia and Aetna prior to any loan commitment.

58. The deed of trust from Debtor to Wachovia, recorded on May 13, 1966, in the office of the Register of Deeds of Guilford County, North Carolina, then constituted a first lien on the property therein described, and since its recordation occurred before any materials were furnished or labor performed in connection with Debtor's apartment project, no person, firm, or corporation can obtain any lien or reduce any claim to judgment which can be superior or equal to the lien created by said deed of trust, and the lien created

thereby is now a first lien upon the property therein described.

59. Debtor secured a policy of title insurance, issued by Chicago Title Insurance Company, through its agent, North Carolina Title Company an affiliate of Wachovia, insuring that Wachovia's deed of trust was in fact a first lien on the property described in said deed of trust and in the title policy. The premium on this policy, paid for by Debtor, was approximately $1,800.00. This represented payment in full of the premium on said policy and no further premium payment was required to be made at such time as the Wachovia note and deed of trust were to be assigned to Aetna. An endorsement changing the named insured under said policy from Wachovia to Aetna was to be made at the time of such assignment. No new policy was to be issued.

60. Wachovia, by reason of its deed of trust, is the holder of one hundred per cent (100%) of the claims secured by a first lien on Debtor's property. There are no liens or claims which are not subordinate to the lien of this deed of trust. The Trustee's Plan does not affect the priority of this lien.

61. The present fair market value of Debtor's apartment project is at least $750,000.00/$760,000.00. The only secured indebtedness of Debtor consists of the Wachovia note in the principal amount of $640,000.00 (on which there has been advanced approximately $632,500.00 and on which there is a balance due as of December 1, 1969, of $602,223.08) and the Kavanagh-Smith & Company note in the principal amount of $33,000.00, upon which there is a balance as of November 28, 1969, of $18,610.14. All monthly curtailment payments on the Kavanagh-Smith & Company note have been made by Debtor in exact accordance with its terms. At present, there are 13 persons, firms, or corporations who have filed claims for either labor and/or materials

furnished in connection with the construction of the apartment project. Several of these unpaid creditors now have liens against the Debtor's property. All of such liens are junior to the liens created by Wachovia's deed of trust (which is a second lien). The total claims filed by material furnishers and/or laborers amount to $46,377.12. The sum of $21,900.00 owed by Debtor is an unsecured loan made to Debtor by a family corporation of Silverman, and in the proposed Plan of Reorganization is considered as a capital contribution by him.

62. Debtor has never been insolvent, but has been unable to pay its debts as they mature, until the proposed Plan of Reorganization was submitted.

63. Debtor's petition complies in all respects with the requirements of Chapter X, Corporate Reorganization of the Bankruptcy Act, and was filed in good faith as determined in the opinion filed in this cause by the United States Court of Appeals for the Fourth Circuit. See *Wachovia Bank and Trust Co. v. Charles F. Dameron, Trustee,* 406 F (2d) 803, decided February 5, 1969.

64. From the time the commitments were made by Wachovia-Aetna in October, 1965, the interest rate demanded for loans of the type involved here has increased. The market rate in April of 1967 for such loans was 7%-7¼%. The present (December, 1969) interest rate for such loans is 9½%-10% with the lender taking a portion of the gross income of between 2%-3%.

65. Notwithstanding a provision in the Buy-and-Sell Agreement executed between Wachovia-Aetna and the Debtor which provided, "Aetna shall have the option to make said purchase even though less than all of the conditions hereinafter provided shall have been met," Wachovia did not offer the loan, as it existed on May 30, to Aetna

for its determination as to whether Aetna would accept it or reject it.

66. If Wachovia were to be paid in full on the loan to Debtor, the same amount of loan, under existing market conditions would not be worth substantially more to the lender.

67. Archie C. Walker, as Trustee under Wachovia's deed of trust, undertook to foreclose its deed of trust on July 20, 1967, and advertised the sale of Debtor's property under the power of sale in said deed of trust. Said sale was noticed to be held on August 16, 1967. The foreclosure was restrained by order of this Court on July 27, 1967. At said time, Archie C. Walker was a full-time employee and officer of Wachovia, as well as Trustee under said deed of trust.

68. Wachovia and Aetna are not at arm's length with each other in this transaction, but occupy a position of joint venturers. Wachovia, in addition to collection of interest at 6% on all money advanced by it pursuant to the loan, benefited from the title insurance premium paid, would have benefited upon transfer of the loan, and after transfer of the loan was to be compensated by Aetna for servicing the loan. As correspondent for Aetna, Wachovia made the arrangements for Aetna to participate as the "permanent" lender, and Debtor itself did not initiate Aetna's selection as such. Wachovia's officer and full-time employee was president of the company acting as agent and broker for the company issuing the title policy and as such made his own determination as to requirements and conditions in respect to said policy. This same officer was likewise Trustee under Wachovia's deed of trust which it undertook to foreclose (Finding of Fact 67) and was, at said time, regularly employed as an officer of Wachovia. As correspondent for Aetna, Wachovia's recommendations are accepted by Aetna.

69. Under all of the circumstances as reflected by the

foregoing Findings of Fact, it would be unfair, inequitable, and unjust to the Debtor and its creditors, other lien holders and stockholders to permit Wachovia and Aetna to undertake to avoid their commitments, even assuming arguendo that some highly technical grounds exist upon which it might attempt to declare its loan in default. There has been no default in repayment of said loan in accordance with its terms and the agreements of the parties, and under the Chapter X proceeding, the Trustee is now and has been making such payments, and there is no indication that such payments cannot hereafter be made from the substantial income produced by Debtor's property.

70. There is no explanation in the record for the discussion between officers of Wachovia and personnel of Kavanagh-Smith & Company relating to a proposal by Kavanagh-Smith & Company to purchase Debtor's property, although the refusal of Kavanagh-Smith & Company to subordinate its deed of trust precluded Debtor from obtaining further funds which were available to pay off unsecured claimants and these unpaid claims and liens arising there from provided Wachovia with one of the grounds upon which it endeavored to declare the loan in default. Wachovia's employee who had these discussions was formerly an employee of Kavanagh-Smith & Company.

71. Debtor substantially complied with all of the material requirements of Wachovia and Aetna in respect to the loan.

72. All obligations of the Trustee for expense incurred for maintenance, repair, and upkeep have been paid promptly and in full during the operation of the apartment project under this Chapter X proceeding. At no time has the Trustee borrowed any money in order to meet any expense incurred.

73. Upon implementation of the Plan of Reorganization,

the collateral security for secured creditors (Wachovia Bank and Trust Company and Kavanagh-Smith & Company) will consist of precisely what was contemplated at the time their respective deeds of trust were executed, with the additional assurance that almost three years of operation have confirmed the unqualified success of the apartment project offered as collateral security.

74. Wachovia Bank and Trust Company accepted the Debtor's 20-year note, payable in monthly installments, and agreed to loan funds to Debtor for the construction of the apartment project. This note was, and is now, and at all times has been, secured by a first lien deed of trust, superior to any and all claims of every type and kind. It continues as such under the Plan proposed by the Trustee.

75. The "Buy-and-Sell Agreement" executed between Debtor, Wachovia and Aetna Life Insurance Company expressly states its loan to Debtor was *"contingent upon the agreement of Aetna"* to provide permanent financing by purchasing Debtor's note. The Buy-and-Sell Agreement expressly states *"Aetna has agreed to purchase"* the Wachovia note, and further provided that *Debtor would not accept a permanent first mortgage from anyone other than Aetna.*

76. Aetna's obligation to purchase was contingent upon certain enumerated conditions set forth in the "Buy-and-Sell Agreement," with a proviso that *"Aetna shall have the option to make said purchase even though less than all of the conditions hereinafter provided shall have been met."*

77. *At no time did Wachovia request Aetna to purchase its note, nor offer it to Aetna.* Instead, Wachovia reached a unilateral decision to attempt to declare the note in default and instituted foreclosure proceeding. (Findings of Fact Nos. 48, 49, 50, 65, and 67 above). Aetna was never afforded the opportunity to exercise its option to buy the note, and

at no time prior to the attempted foreclosure by Wachovia did Aetna refuse to purchase the note.

78. Wachovia elected to declare its note in default rather than submit it to Aetna for purchase. As heretofore found (Findings of Fact Nos. 53 and 71), no substantial reason existed for Wachovia's attempt to declare the loan in default.

79. Nothing in the Buy-and-Sell Agreement required Debtor to secure any other permanent lender in the event Aetna did not purchase Wachovia's note. The agreement expressly provided that "Wachovia agrees not to sell to anyone but Aetna unless Aetna fails to purchase." Debtor was precluded from obtaining a permanent first mortgage from anyone other than Aetna under the terms of the Buy-and-Sell Agreement.

80. All payments, including all interest payments, due on Wachovia's note have been made in accordance with its terms. No default in payment exists. The proposed Plan calls for an uninterrupted continuation of installment payments on the note in the exact amount therein provided ($4,586.67) per month). The Plan does not increase or decrease the curtailment period, the interest rate, the monthly payments, or any other aspect of the note. In fact, the payments will accelerate payment to Wachovia since the installment payments are computed on retirement of a $640,000.00 loan over a 20-year period, when in fact the principal amount actually loaned was approximately $632,500.00.

81. The proposed Plan provides for payment to Kavanagh-Smith & Company of its note, secured by a second deed of trust, in exact accordance with its terms. No default has ever existed in respect to this note, which was in the original principal amount of $33,000. The balance as of November 28, 1969, is $18,610.14. Monthly payments are $482.10.

82. The Wachovia note of May 13, 1967, was in the principal amount of $640,000.00. By reason of the continuous, successive monthly installment payment made thereon by the Trustee, each in the amount provided for in said note ($4,586.67), the balance on said note as of December 1, 1969, is $602,223.08.

83. The first lien deed of trust securing Wachovia's note in the principal amount of $640,000.00 recorded in the Office of Register of Deeds of Guilford County, North Carolina, on May 13, 1967, then constituted a first lien on the property therein described (Finding of Fact No. 58). Said deed of trust will continue to constitute a first lien deed of trust, in all respects, under the proposed Plan of Reorganization. No provision of the proposed Plan affects the security or priority of Wachovia's first lien.

84. Nothing in the Buy-and-Sell Agreement between Debtor, Wachovia, and Aetna required Debtor to secure a purchaser for Wachovia's note in the event it was not purchased from Wachovia by Aetna.

85. The obligation of Debtor in respect to the first lien secured creditor is evidenced by Debtor's promissory note of May 13, 1967, in the principal amount of $640,000.00, payable to Wachovia Bank and Trust Company. Payment of this note in accordance with its terms, under the circumstances as they exist in this case, does not alter, modify, or change the status of Wachovia as a secured first lien creditor.

86. The proposed Plan of Reorganization complies with every applicable provision of Sec. 216 (U.S.C.A. Sec. 616) as set forth below:

(a) All unsecured creditors filing claims are to be paid in full.

(b) Provision is made for payment of costs and expense of administration.

(c) Claims for Federal and State taxes are to be paid in full.

(d) Claims for City and County ad valorem taxes are to be paid in full.

(e) The stockholder of Debtor is not affected by the Plan, except as provided in subparagraph (i) below. (See Finding of Fact No. 13(e).

(f) The two secured creditors, i.e., Wachovia and Kavanagh-Smith & Company are not affected by the Plan by reason of the provision in the Plan which provides that each of said secured creditors shall continue to receive payment in cash of the monthly installment payments in exact accordance with the terms and provisions of their respective secured promissory notes.

(g) In the event either secured creditor (Wachovia or Kavanagh-Smith & Company) shall be determined to be affected by the proposed Plan of Reorganization, the provision of the Plan requiring payments to each in strict accordance with their respective secured notes constitutes a method which will, under and consistent with the circumstances of this case (as evidenced by the foregoing Findings of Fact), equitably and fairly provide adequate protection for the realization by them of the value of their claims against the property dealt with by the Plan and affected by such claims, in accordance with Sec. 216(7) of the Act.

(h) Provides for the return of possession to Debtor upon implementation of the Plan.

(i) Provides that the sum of $50,000.00 made available to the Trustee shall constitute additional contribution of capital, to be capitalized by the issuance to the stockholder of 500 shares of common stock of Debtor corporation.

(j) Provides for corporate charter amendment in compliance with the provisions of Section 216(12)(a) and (b).

87. Debtor's apartment project has a present fair market value of at least $750,000.00/$760,000.00. The total value of all secured claims amounts to $620,833.22. The success of the operation of Debtor's apartment project by the Trustee over a three-year period clearly demonstrates the feasibility of the proposed Plan of Reorganization. To undertake liquidation of Debtor's assets in order to pay off secured creditors in full, would under the existing money market, eliminate all possibility of payment of unsecured creditors, tax claims, and would extinguish all stockholder equity.

UPON THE FOREGOING Findings of Fact, the undersigned, as Special Master, makes the following

CONCLUSIONS OF LAW

1. *This matter is a proper case for proceedings under the provisions of Chapter X of the Bankruptcy Act.*

"Chapter X, like its predecessor Sec. 77B, is a remedial statute, designed to effect the rehabilitation of corporate debtors through a legal method of reorganization which conserves the going-concerning values of the property, avoids foreclosures and forced sales and enables the debtor to continue operations, yet affords full consideration of the rights of creditors and stockholders." *Collier on Bankruptcy,* 14th Ed., Vol. 6, Sec. 0.11, page 116; see also: *Hutson v. United States,* 96 F Supp. 909 (W.D.Pa., (1951)).

"Reorganization procedure does not seek to divide the proceeds of a liquidation of the assets of the debtor. Rather it preserves from destruction going concern values which are thus made available for the payment of claims against an interest in the debtor. It avoids consequences to debtors and creditors of foreclosure,

liquidations and forced sales with their drastic deflationary effects." *In the Matter of Dover Boiler Works, Inc.*, 38 F. Supp. 701 (D.N.J. (1941)).

2. *The petition of Debtor under Chapter X of the Bankruptcy Act was filed in good faith.*

(See *Wachovia Bank and Trust Co. v. Dameron*, 406 F. (2d) 803, 1969).

3. *The Plan of Reorganization submitted by R. Kennedy Harris, Trustee, complies in all respects with the provisions of Sec. 216 of the Bankruptcy Act (11 USCA 616) and is fair, equitable, and feasible as to all creditors, secured and unsecured, the stockholders and all other parties in interest.*

4. *Notwithstanding the objections of Wachovia, all as set forth in its Objections to Proposed Plan of Reorganization filed herein on October 3, 1969, said Plan, under the facts hereinabove found, constitutes a method which equitably and fairly provides adequate protection for the realization by Wachovia of the full value of its claim against the property dealt with by the Plan and affected by its claim, all in accord with the provisions of Section 216(7) of the Bankruptcy Act (11 USCA, 616(7)).*

This provision is as follows:

"*Section 216 — Provisions of Plan.*

A plan of reorganization under this Chapter —

(7) shall provide for any class of creditors which is effected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or

sale, or by the retention by the debtor, of such property subject to such claims; or (b) a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) *by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide* such protection;" (Italics added)

5. *Wachovia Bank and Trust Company is not entitled to immediate payment of its secured claim in the amount of $602,223.08.*

6. *Assuming arguendo that some technical ground existed for Wachovia's contention that its loan was in default, there being no material default, the circumstances of this case equitably justify Conclusion of Law No. 4 above set forth and said conclusion, as a matter of law, is wholly consistent with the provisions and purposes of Chapter X of the Act.*

RECOMMENDATIONS

Upon the foregoing Findings of Fact and Conclusions of Law, the undersigned, as Special Master, recommends to the Court that an order be entered, providing

1. That the report of the undersigned be adopted by the Court, and the Findings of Fact and Conclusions of Law made by the undersigned, as Special Master, be made the Findings and Conclusions of the Court.

2. For approval of the Plan of Reorganization filed by R. Kennedy Harris, Trustee, including a determination that the Plan complies with the provisions of Section 216 of the Bankruptcy Act and is fair, equitable, and feasible.

3. For compliance by the Trustee with the provisions of Section 175 of the Bankruptcy Act in respect to submission of information to creditors and stockholders.

4. For the fixing of a time within which the creditors and stockholder affected thereby may accept the Plan as approved by the Court.

Respectfully submitted, this the 29 day of January, 1970.

/s/Rufus W. Reynolds
Referee in Bankruptcy for the United States District Court, Middle District of North Carolina, and Special Master, Pursuant to Order of July 27, 1967.

PLAN OF REORGANIZATION

R. Kennedy Harris, Trustee herein, hereby proposes the following plan of reorganization:

Introductory Statement

Cabana Club Apartments, Inc., debtor, is a corporation organized and existing under and by virtue of the Laws of the State of North Carolina.

Debtor has an authorized capital of $100,000.00, shares of the par value of $100.00, each, of which $400.00 is issued and outstanding.

Cabana Club Apartments, Inc. was originally chartered under the name of Point Homes, Inc., and subsequently its corporate name was changed to Cabana Club Apartments, Inc.

On July 27, 1967, Honorable Edwin M. Stanley, Chief Judge, United States District Court for the Middle District of North Carolina entered an order approving Debtor's petition for proceeding under Chapter X of the Bankruptcy Act and appointed Charles E. Dameron, III as Trustee of the debtor; that Charles E. Dameron, Trustee operated Debtor's business until his resignation in the fall of 1968, when, on October 23, 1968, the Court appointed R. Kennedy Harris, Trustee of the Estate of Cabana Club Apartments, Inc. and R. Kennedy Harris, Trustee took over the assets and management of Debtor's property on November 11, 1968.

There are 80 apartment units available for rent. The maximum rents available each month is presently $10,210.00, 95% or $9,700.00, of which is the average monthly amount of rent collected. The average monthly cost of operation, including Professional Management Commissions is $2,668.00. In addition, there is estimated accrued combined City and County Ad Valorem Tax monthly expense of $1,210.00. The estimated monthly expense of Trustee's fees is $500.00. Wachovia Bank and Trust Company first Lien Deed of Trust Note payments are $4,586.67 monthly and Kavanagh and Company Second Lien Deed of Trust Note payments are $482.10 monthly.

In Summary:

Average monthly income	$ 9,700.00
Monthly Expenses and Note Payments, including Accrued Ad Valorem Taxes, not including Trustee fee	8,946.77
Net Estimated Monthly Income after expense	$ 753.23

Anticipated income and Capital for 3 months

from the time Plan of Reorganization is filed is as follows:

3 months anticipated net income	$ 2,260.00
Money on hand as of July 1, 1969	8,576.83
From Alvin Silverman, stockholder	50,000.00
Amount due from Wachovia Bank and Trust Company as refund of deposit by debtor at time of application of loan for $640,000.00	6,400.00
Total Anticipated income and Capital	$67,236.83

(note: In addition trustee has on hand $5,262.50 in security deposits on rent contracts)

Estimated Claims against debtor filed by Laborers and Material furnishers but not yet proved and allowed $51,017.57

(note: $11,820.64 of the Claim of Wright Homes, Inc., bankrupt, for $20,931.00 is disputed by debtor corporation)

1967 U. S. Internal Revenue Claim	$ 930.74	
1967 City of Greensboro Ad Valorem Tax Claim	4,167.62	
1967 Guilford County Ad Valorem Tax Claim	4,367.62	
Total Tax Claims	$9,465.98	9,465.98

Estimated Cost of Administration and Court Costs to be paid	5,000.00
Total estimated Claims, other than mortgage payments, taxes and costs	$65,483.55

It is estimated by Trustee that the Claim of Wright Homes, Inc. Bankrupt, will be reduced by at least $5,000.00 leaving Laborers and Material Furnishers Claims to be paid in the sum of $46,117.57, instead of $51,017.57, thus reducing total claims, other than mortgage payments, to **$60,483.55** to be paid for from the estimated anticipated income and capital of $67,236.83. Should the plan be approved and the assets returned to the Debtor Corporation, the Corporation would realize an additional 500.00 per month income, which sum is now being paid each month as an advance on Trustee's fee.

CLASSIFICATION OF CREDITORS AND STOCKHOLDERS

Creditors:

A. Deed of Trust Lien Holders: (1) Wachovia Bank and Trust Company, holder of First Deed of Trust, (2) Kavanagh-Smith & Co., holder of Second Deed of Trust

B. Liens For Taxes

1. The United States respecting its claim for taxes
2. The State of North Carolina respecting its claim for taxes (if any)
3. The City of Greensboro, North Carolina, respecting its Claim for taxes
4. The County of Guilford, North Carolina, respecting its Claim for taxes.

C. Laborers and Material Furnishers Liens:
Hollowell & Associates, Inc.
Arthur A. McDonald, Jr., Trustee and Bankruptcy of Wright Homes, Inc.
Air-Flo Heating and Air Conditioning Company
Artis Plumbing Company
Builders Wholesale, Inc. t/a K & W Floor and Wall Specialty Co.
A. C. Bowling, d/b/a Bowling Sound Service
C. W. Gadson, t/a Twin City Electric Contracting Company
Charles W. Chance, t/a Chance Construction Company
Westinghouse Electric Supply Company
Cox Swimming Pool Company
Delta Wood Industries, Inc.
Hotpoint, a division of General Electric Company

Stockholders:
D. Holders of Common Stock's — Alvin Silverman
There are no claims filed by General Creditors

The Proposed Plan

I. Creditors in class B shall be paid in full in cash immediately upon confirmation of the plan.

II. Secured creditors unaffected by plan:
1. Class A creditor Wachovia Bank and Trust Company shall not be affected by the plan but shall receive in cash monthly payments in accordance with the tenor of its note secured by a First Lien Deed of Trust on the real and personal property of the debtor. Should it be determined by the Court that Class A creditor, Wachovia Bank is affected by the plan or Wachovia Bank and Trust

Company does not accept this plan then and in that event the Court should provide an order that Wachovia Bank and Trust Company be paid in cash monthly payments in accordance with the tenor of its existing note secured by a First Lien Deed of Trust on the real and personal property of the debtor which will equitably and fairly provide protection for the realization by the Bank of the value of its claim.

2. Class A creditor, Kavanagh-Smith & Co. shall not be affected by the plan but shall receive in cash monthly payments in accordance with the tenor of its note secured by a First Lien Deed of Trust on the real property of the debtor. Should it be determined by the Court that Class A creditor, Kavanagh-Smith & Company is affected by the plan and or Kavanagh-Smith & Co. does not accept this plan then and in that event the Court should provide an order that Kavanagh-Smith & Company be paid in cash monthly payments in accordance with the tenor of its existing note secured by a First Lien Deed of Trust on the real property of the debtor which will equitably and fairly provide protection for the realization by the Kavanagh-Smith & Company of its value of its claim.

3. Creditor in Class C shall not be affected by the plan but shall receive in cash 100% of the claims as approved and allowed to the extent hereinafter provided.

III. Stockholders affected by the Plan: Stockholders in Class D are not to be affected.

IV. Costs, expenses and allowances: It is proposed that

the debtor pay in full, in cash, all costs and expenses of administration and all other allowances which may be approved or made by the Judge.

V. The charter of the debtor corporation shall be amended by a provision in said charter prohibiting the debtor from issuing non-voting stock, and providing in the event there are several classes of the securities of the debtor for the fair and equitable distribution of such power among such classes; and said amended charter shall make provisions which are fair and equitable and in accordance with sound business and account practice, with respect to the terms, position, rights and privileges, of the several classes of securities of the debtor if any shall exist after payment by the Trustee under the plan of all creditors in Classes B and C; and making provision with the response to the making, not less than once annually of periodic reports to security holders which include profit and loss statements and balance sheets prepared in accordance with sound business and accounting practice.

VI. Means of Affecting the Plan if the Plan is Confirmed by the Court, Within 60 days thereafter the Plan Will Be Executed As Follows:

Alvin Silverman, stockholder, will put up in cash $50,000.00, which with other capital and earnings on hand, will be used to pay the cash outlays provided for by the plan; the $50,000.00 cash will be put up by Alvin Silverman pursuant to the agreement annexed hereto marked exhibit "A"; the letter referred to in the agreement marked exhibit "A", will be filed with the Court within three weeks from July 28, 1969; the $50,000.00 advanced by Alvin Silverman will be

capitalized by the debtor corporation issuing to Alvin Silverman 500 shares of common stock of the debtor corporation; monthly payments will be made to the holders of the First and Second Lien Deed of Trust upon the debtor's property in accordance with the terms of the notes secured by said Deed of Trust; The Trustee will pay in full all creditors in Classes B and C; costs and expenses of the administration and allowances made by the Court; and thereupon the Trustee will return all of the property and assets of the debtor corporation back to the officers and directors of said corporation who were the officers and directors at the time the Reorganization Petition was filed in this cause.

VII. Non-Assenting Creditors and Stockholders.
In respect of any class of creditors affected by and not accepting this plan by the requisite two-thirds majority in amount, adequate protection for the realization by them of the value of their claims shall be given by such method as will in the opinion of the Judge and consistent with the circumstances of the case, equitably and fairly provide such protection. In respect to any class of stockholders, affected by and not accepting the plan by the requisite majority of stock, adequate protection for the realization by them of the value of their equity, if any, shall be given by such method as will in the opinion of the Judge, and consistent with the circumstances of the case, equitably and fairly provide such protection.

VIII. Periodic Report: The debtor corporation should be required by the Judge to make annually reports to the holders of First and Second Deeds of Trust, including profit and loss statements and balance sheets

prepared in accordance with sound business and accounting practice.

Respectfully submitted this 28th day of July, 1969

/s/R. Kennedy Harris

R. Kennedy Harris, Trustee

"EXHIBIT A"

THIS AGREEMENT, Made on this the 25th day of July, 1969, by and between ALVIN SILVERMAN, of Fort Lauderdale, Florida, herein designated STOCKHOLDER, and R. KENNEDY HARRIS, Trustee, of Guilford County, North Carolina, herein designated TRUSTEE,

WITNESSETH:

STOCKHOLDER is the owner of all of the issued and outstanding shares of the capital stock of Cabana Club Apartments, Inc., a North Carolina corporation, said issued and outstanding shares consisting of four (4) shares of $100 each.

TRUSTEE is the duly appointed, qualified, and acting Trustee of Cabana Club Apartments, Inc., pursuant to an order entered by the Honorable E. M. Stanley, United States District Judge for the Middle District of North Carolina, on the 23rd day of October, 1968, said order having been entered in that certain Chapter X Reorganization proceeding wherein Cabana Club Apartment, Inc., is debtor.

TRUSTEE has been directed by said Court to file a Plan of Reorganization of said Cabana Club Apartments, Inc., not later than July 28, 1969.

In connection with the proposed plan of reorganization which the TRUSTEE contemplates submitting to the Court, one of the provisions of said plan provides for the payment, as additional capital of Cabana Club Apartments, Inc., by

STOCKHOLDER of the sum of $50,000, said payment to be made by STOCKHOLDER to TRUSTEE and used by TRUSTEE solely for the purpose of discharging to the extent set forth in said plan all of the claims allowed against said debtor corporation in full, except the obligations of Wachovia Bank and Trust Company and Kavanagh-Smith & Company, and to the discharge in full all cost and expense incurred in connection with said Chapter X.

NOW, THEREFORE, in consideration of the filing of the proposed Plan of Reorganization by TRUSTEE and the mutual covenants and agreements to be performed by each of the parties hereto, as the same are hereinafter set forth, the parties hereto do hereby contract and agree as follows:

1. STOCKHOLDER will deliver to the TRUSTEE the sum of $50,000, in cash, at such time as the proposed Plan of Reorganization to be submitted by the TRUSTEE, a copy of which plan is attached to and made a part of this agreement, has been, in all respects, finally approved by an order entered by the United States District Court or a judgment by an appellate court affirming such order and from which such judgment no appeal may thereafter be taken.

2. Upon the payment by the TRUSTEE of all creditors of the debtor corporation, Cabana Club Apartments, Inc., in the manner and to the extent set forth in the attached copy of Plan of Reorganization, the assets, including all property, both real and personal, of said debtor corporation be returned by the TRUSTEE and/or the Court to said corporation so that STOCKHOLDER may thereupon assume the management, operation, and control of said corporation, free and discharged from the jurisdiction of the Court in said Chapter X Reorganization.

3. As evidence of the availability of STOCKHOLDER

to perform this agreement in accordance with its terms and to deliver, upon the occurrence of the conditions hereinabove set forth, the sum of $50,000 to TRUSTEE, STOCKHOLDER has attached to this agreement satisfactory evidence of his ability to meet this requirement of this agreement.

It is the intent and purpose of this agreement to insure to the TRUSTEE the availability of the sum of $50,000, in cash, at such time as the attached proposed Plan of Reorganization is approved by an order of Court or a judgment affirming such order from which no appeal can be taken, it being specifically understood and agreed that the payment of additional capital to the debtor corporation, Cabana Club Apartments, Inc., is contingent and predicated upon the claims of Wachovia Bank and Trust Company and Kavanagh-Smith & Company being paid in accordance with the terms of the respective notes evidencing the obligations giving rise to their respective claims and is further contingent and predicated upon the operation, management, and control of debtor corporation being vested in STOCKHOLDER immediately upon the consummation of said Plan of Reorganization according to its terms.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals, on this the day and year first above written.

/s/R. Kennedy Harris (Seal)
Trustee

/s/Alvin Silverman (Seal)

Sworn to and subscribed before me this 25th day of July, 1969.

My commission expires: May 20, 1972.

/s/Kathleen Parkinson
Notary Public State of Florida at Large

WACHOVIA BANK AND TRUST COMPANY,
Appellant,

v.

Charles E. DAMERON, III, Trustee of the Estate of Cabana Club Apartments, Inc., Appellee.

In the Matter of CABANA CLUB APARTMENTS, INC., Debtor.

No. 12472.

United States Court of Appeals
Fourth Circuit.
Argued Nov. 1, 1968.
Decided Feb. 5, 1969.

Hubert Humphrey, Greensboro, N. C. (McLendon, Brim, Brooks, Pierce & Daniels, Greensboro, N. C., on brief), for appellant.

Arthur O. Cooke, Greensboro, N. C. (Cooke & Cooke, Greensboro, N. C., on brief), for appellee.

Before SOBELOFF, WINTER and BUTZNER, Circuit Judges.

BUTZNER, Circuit Judge:

Wachovia Bank & Trust Co. appeals from an order of the district court denying its motion to dismiss a petition for reorganization under Chapter X of the Bankruptcy Act [11 U.S.C. § 501 et seq.] filed by Cabana Club Apartments, Inc. The appeal raises the narrow issue of whether the debtor's petition complied with Chapter X and was filed in good faith within the meaning of § 146(3) and (4) of

the Act [11 U.S.C. § 546(3) and (4)].[1] We affirm the district court's denial of the motion to dismiss.

The debtor obtained from Wachovia a construction loan to build an apartment in Greensboro, North Carolina. It received through Wachovia a commitment for a long-term financing from the Aetna Life Insurance Company. On May 10, 1966, before construction began, the debtor executed its note, secured by a first trust, in the sum of $640,000 payable to Wachovia in monthly installments of $4,566.07, beginning April 1, 1967. Simultaneously, Wachovia, Aetna, and the debtor executed a "buy and sell" agreement for the assignment of the note to Aetna upon completion of construction.

Differences between Wachovia and the debtor culminated in Wachovia's declaring the loan in default on May 30, 1967 and demanding accelerated payment of the disbursed proceeds of the loan in the sum of approximately $632,500. On July 20, 1967 Wachovia authorized the trustee to sell the property, but before the foreclosure sale, the debtor filed its petition under Chapter X. The district court restrained

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[1] Section 144 of the Act [11 U.S.C. § 544] states:

"If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied."

Section 146 [11 U.S.C. § 546] provides in part:

"Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if —

"(3) it is unreasonable to expect that a plan of reorganization can be affected; or

"(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

the sale, appointed a trustee and referred the case to the referee in bankruptcy, as special master. The court adopted, with minor exceptions, the findings and conclusions reported by the referee. It accepted his recommendation to deny the motion to dismiss, but rejected his recommendation to tax costs and attorney's fees against Wachovia.

Wachovia contends that the debtor did not construct the project according to the plans and specifications; that the note is in default because the debtor did not pay installments due in April, May, and June 1967; that the debtor defaulted in its obligations undertaken to secure financing by failing to pay all costs of construction when the project was finished, by failing to provide good title insurance, and by failing to grant a first lien on chattels which are serviceable in the operation of the apartment. Contrary to Wachovia's allegations, the referee found that the project was completed in accordance with the plans and specifications on May 17, 1967. It was then 80% rented. At the time of the hearing, he found, the apartments were 100% rented with good prospects for substantial occupancy in the future. He estimated the annual net income at $25,000 to $30,000 after servicing secured debt and paying all operating expenses. He reported the fair market value of the project was $900,000. The secured debt consists of Wachovia's $640,000 first lien and a $33,000 second trust. Unsecured indebtedness consists of $21,900, which the referee treated as a capital contribution, and about $52,000 due on construction costs. All unsecured creditors are willing to accept payment over a period of time.

The referee also found Wachovia's note was not in default. He held that the date for payment of the initial installment was extended to July 1, 1967, and at that time, the debtor tendered a check for principal and interest which was refused. In the meantime, Wachovia had received with-

out protest, in accordance with an understanding reached by the parties, interest payments in April, May, and June 1967. Since the institution of this suit, the trustee, without prejudice to Wachovia, has been making the installment payments.

The principal difficulty confronting the debtor is its inability to pay or settle construction claims in the approximate amount of $52,000.[2] These claims caused exceptions in the title policy and prevented the debtor from giving a first lien on the chattels. While Aetna's commitment was conditioned upon the debtor's payment of all construction costs, Aetna had the option to waive this requirement. The referee found that Wachovia, however, did not offer the note to Aetna to determine whether it would accept or reject the loan, but instead, without justification, unilaterally called the note and ordered the foreclosure sale.

Wachovia argues that its opposition to any plan of corporate reorganization[3] conclusively proves impossibility of effecting a plan and consequently establishes lack of good faith. Three cases in this circuit have dealt with the effect of lienholders' opposition on the issue of good faith. In Arey & Russell Lumber Co. v. American Nat'l Bank & Trust Co., 201 F.2d 508 (4th Cir. 1953), the background of previous proceedings and the petition in the Chapter X pro-

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2. About $7,500 undisbursed funds and a $6,400 commitment fee furnished a possible source of partial payment. The debtor contests about $11,000 of the claims. Thus, the amount needed to discharge the claims ranges from about $28,000 to $39,000 depending on the determination of the contested claim. The debtor was unsuccessful in borrowing $50,000 to pay the claims because the holder of the second trust declined to subordinate to the proposed loan.

3. Section 179 of the Act [11 U.S.C. § 579] requires a reorganization plan to be acceptable to "creditors holding two-thirds in amount of the claims filed and allowed of each class." Wachovia holds all first lien indebtedness and more than two-thirds of all claims.

ceeding showed that the only purpose of reorganization was to secure an extension of indebtedness which the lienholder opposed. The court recognized that further proceedings would be fruitless and dismissed the petition. On similar grounds a petition was dismissed in Leas v. Courtney Co., 261 F.2d 13 (4th Cir. 1958). Nevertheless, in the absence of conclusive demonstration of futility found in such exceptional cases as *Arey* and *Leas,* creditor opposition is not controlling. This is made clear in Janaf Shopping Center, Inc. v. Chase Manhattan Bank, 282 F.2d 211 (4th Cir. 1960), where creditor opposition expressly was held not to be determinative, but instead was weighed along with other factors that had a bearing upon the possibility of successful reorganization.

[1] The inability to effect a plan of reorganization that characterized *Arey, Leas,* and *Janaf* does not appear at this stage of these proceedings. The completion of the project without major difficulties and its successful operation indicate reasonable prospects for a workable plan. The principal impediment appears to be the rise of interest rates,[4] but this foretells a difficulty, not an impossibility. The district court properly concluded the trustee should have an opportunity to work out a plan "even though opposing interests claim in advance that any plan proposed will be futile." 6 Collier on Bankruptcy § 6.09 at 1043 (14th ed. 1965).

[2] Wachovia also complains that the referee's conclusions are predicated upon wrongfully deferring payment of its 20-year note. We do not read the report and the confirming order so narrowly. The referee outlined alternative proposals to demonstrate the feasibility of a plan. He first

[4] From the time of the financing commitment in October 1965 until the hearing, interest rates increased for this type of loan from 6% to 7 or 7¼%, according to uncontroverted findings of the referee.

suggested that Wachovia could be paid in full by arranging other long-term financing. He also suggested paying Wachovia according to the terms of the note as a non-accepting creditor under § 216(7) of the Act [11 U.S.C. § 616(7)]. But a plan has not yet been formulated, and the Act does not sanction our consideration of the referee's suggestions in lieu of a plan. After the trustee has presented a plan, it will be time enough to consider its merits and legality. At this stage of the proceedings, it is sufficient to hold that there is a reasonable expectation that a plan can be effected. Neither the petitioner nor the trustee is required to prove at the outset of the proceedings "the fairness, feasibility or equity of any particular plan or possible plans." 6 Collier on Bankruptcy § 609 at 1041 (14th ed. 1965).

[3] It is unnecessary at this time to determine whether Wachovia properly initiated foreclosure proceedings. Even if default be assumed, the district court acted neither erroneously nor arbitrarily in deciding that creditors and stockholders would not be served best by a foreclosure sale. Liquidation by forced sale furnished no assurance that all liabilities could be paid. In contrast, the referee reported reorganization reasonably could be expected to achieve this end. Although foreclosure might bring enough to pay the balance due on the first and second liens, jeopardy to junior creditors justified the district judge's conclusion. See Marine Harbor Properties v. Manufacturing Trust Co., 317 U. S. 78, 86, 63 S.Ct. 93, 87 L.Ed. 64 (1942) (dictum).

The order of the district court is affirmed and this case is remanded for further proceedings.

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IN THE

Supreme Court of the United States

Spring Term, 1972

No.

WACHOVIA BANK AND TRUST COMPANY,
Petitioner

v.

R. KENNEDY HARRIS, TRUSTEE OF THE ESTATE OF CABANA CLUB APARTMENTS, INC.,
Respondent

IN THE MATTER OF:

CABANA CLUB APARTMENTS, INC.,
Debtor

BRIEF OF RESPONDENT-DEBTOR IN OPPOSITION TO PETITION OF WACHOVIA BANK AND TRUST COMPANY FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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INTRODUCTORY NOTE

For brevity and convenience, Wachovia Bank and Trust Company, Petitioner, will sometimes be referred to as Wachovia, R. Kennedy Harris, Trustee, will be referred to as Respondent, and Cabana Club Apartments, Inc., will be referred to as Debtor. Page references to the Appendix to Petition are designated (A—). All italics in the text of this brief are supplied unless otherwise noted. Findings of Fact are designated "F.F."

STATUTES INVOLVED

While the several statutory provisions cited in Wachovia's Petition form the basic procedures under which the proposed Plan of Reorganization was ultimately approved by the Referee (acting as Special Master), by the District Court and by the Court of Appeals, it is pertinent to isolate and repeat here the precise statutory provisions formulating the basis for approval of the Plan proposed by the Trustee. These are:

Sec. 216 (11 U.S.C.A. 616) "A plan of reorganization under this chapter —

* * * * * *

"(7) shall provide for any class of creditors affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, *adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims* either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims, or (b) by a sale of such property free of such claims, at no less than a

fair upset price, and the transfer of such claims to the proceeds of such sale, or (c) by appraisal and payment in cash of the value of such claims, or (d) *by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection.*

". . . (9) may include, where any indebtedness is created or extended under the plan for a period of more than five years, provisions for the retirement of such indebtedness by stated or determinable payments out of a sinking fund *or otherwise* (a) if *secured, within the expected useful life of the security therefor,* or (b) if unsecured, or if expected useful life of the security if not ascertainable, then within a specified reasonable time, not to exceed forty years."

STATEMENT OF THE CASE

1. Proceedings Leading to the Petition

Debtor's Petition under Chapter X of the Bankruptcy Act was filed July 27, 1967. Wachovia filed a Motion to Dismiss, raising the issues of whether Debtor's Petition complied with Chapter X and whether it was filed in good faith within the meaning of Sec. 146(3) and (4) of the Act. Following lengthy hearings, the Motion to Dismiss was denied and upon appeal the order of denial affirmed. *Wachovia Bank and Trust Company v. Dameron, Trustee,* (4 Cir. 1969), 406 F. 2d 803. (A-53-58).

Thereafter, the Successor Trustee (R. Kennedy Harris) filed a proposed Plan of Reorganization. Additional hearings were held by the Referee in Bankruptcy, acting as Special Master, on approval of the Plan. The Report of Special Master on Hearing for Approval of Plan of Reorganization (A-13-42), recommended approval of the pro-

posed Plan. The matter then came on for hearing before Honorable Eugene A. Gordon, United States District Judge, who carefully reviewed the proposed Plan and entered an order approving the Plan with a specific modification and additional requirement that Wachovia's secured claim be paid in strict accordance with its terms.

Wachovia's appeal from this order was affirmed by the decision of the United States Court of Appeals for the Fourth Circuit, reported at 455 F. 2d 841, (A-2-11). It is this judgment and opinion which Wachovia now petitions this Court to review by grant of a Writ of Certiorari.

Petitioner contends in its brief that (1) "important and far-reaching questions dealing with the function and application of Chapter X of the Federal Bankruptcy Act are involved"; (2) that "the duty and function of a district judge in considering a plan of reorganization" is involved; and that "the decision of the Fourth Circuit conflicts with applicable decisions of the Supreme Court, as well as other circuits." (Petitioner's Brief, pp 7-8).

A review of the facts and circumstances of this case and the application of the statutory and case law by the Courts below clearly indicate that the foregoing contentions of Petitioner are wtihout merit.

2. **Statement of Facts**

The unique character of the facts of this case, as disclosed by the eighty-seven (87) Findings of Fact appearing on pages 14 through 42 of Petitioner's Appendix, sets it apart from the usual controversy involving Chapter X Plans of Reorganization. The distinctive features of this case were recognized and relied upon by the Referee, acting as Special Master, by the District Judge, and by the Appellate Court in its opinion. Petitioner's recital of facts as set forth in its

brief at pages 8-10 are wholly inadequate to present to this Court a clear and complete picture of this controversy. As stated at the outset of the opinion of the Court of Appeals: "The appeal is largely factual but we will be concise as possible." (A-3).

Petitioner fails to touch upon many factors upon which the Special Master and Court below (including the Appellate Court) considered in approving the proposed Plan of Reorganization. To avoid needless repetition in this brief, Respondent *respectfully urges this Court to examine the Findings of Fact made by the Court* (A 14-42), which set forth in chronological sequence the entire history of this proceeding, including the nature, scope, and extent of the Plan of Reorganization.

The application of the law (particularly Sec. 216 (7) (d)) demonstrates the sound basis for the decision of the Court below.

Special attention is directed to the undisputed fact that Wachovia has always been, and under the approved Plan of Reorganization, will continue to be, the holder of a first lien on Debtor's apartment project. Its loan has been and will continue to be repaid in the manner contracted for repayment. No decrease in interest rate or curtailment payments have been made and none are contemplated.

REASONS FOR DENYING WRIT

The opinion of the Court of Appeals (A 2-11) is not in conflict with any decision of this Court or of any Court of Appeal. It does not deal with any important question of federal law which has "a far-reaching effect" on the use of Chapter X. The opinion simply reflects the application of certain specific statutory provisions to the facts and circumstances of this particular case. As a background for

dealing with the four specific reasons relied upon by Petitioner in its brief, Respondent directs attention to the treatment accorded Section 216 (7)(d) of the Act in Collier on *Bankruptcy,* Vol. 6A, Sec. 16.17, p. 490:

> "Paragraphs (7) and (8), however, contain an omnibus provision which perhaps may be brought into play when other methods fail. Paragraph (7) declares that as to any *non-assenting class of creditors* 'adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims' may be provided '(d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection.'
>
> "It has been said that these methods, properly speaking, are not 'methods' at all, but merely empower the judge, who must approve and confirm the plan to approve any means of treatment which under the *particular circumstances,* 'equitably and fairly' affords adequate protection to the dissenter.
>
> "Admittedly, the potentialities of paragraphs (7)(d) and 8(c) are difficult to define, but there seems to be little reason why they should not remain effective as possible alternatives *to encompass the largely unforeseen case.*"

Respondent now deals with each of the four reasons assigned by Wachovia in support of its Petition for the Writ.

Petitioner contends:

1. **Decision of the Court of Appeals Approving Plan of Reorganization Violate Chapter X Requirements in**

Impairing Rights of Senior Creditors While Paying Junior Creditors in Full.

This argument presented by Wachovia was duly and carefully considered by the Court below and discussed in detail in the opinion of the Court of Appeals. (A-4, 5). There is no deferred or uncertain aspect in payments to be made to Wachovia. The Court below expressly found there was no 13-month arrearage of unpaid principal. Wachovia's position as holder of the first lien note and deed of trust is not "affected" by the proposed plan. Attention is directed to Finding of Fact No. 13(a) (A-17). See also Findings of Fact Nos. 55 and 56 (A-29, 30) which clearly portray the substantial nature of the collateral security. As stated in the opinion below:

> "We see no merit in Wachovia's contention that its rights are impaired because some junior creditors will be paid in full immediately, or prior to full payment to Wachovia. Wachovia will, under the plan, be paid in full in twenty years. *It has no right to more.*" (A-8).

It is significant to note that the collateral security for Wachovia's note and deed of trust has always been and is now a highly successful operation. (F.F. 55, 56, and 57, A-30).

Wachovia further contends:

2. The Plan Does Not Accomplish a Legitimate Corporate Reorganization Contemplated by Chapter X.

Wachovia raised this question on the first appeal *(Wachovia Bank and Trust Company v. Dameron, Trustee, supra)*, contending that Debtor's petition did not fall within the provisions of Chapter X. The Court rejected Wacho-

via's position at that time, and declined to consider it again on the second appeal (A-8).

S.E.C. v. American Trailer Rentals Co., 379 U.S. 594, 85 S.Ct. 513, 13 L.ed. 2d 510 (1965), cited by Wachovia, expressly holds that Chapter X is permissible in any event if the "financial condition of Debtor requires more than a simple composition of unsecured debts."

The cases cited by Wachovia in support of this contention present factual situations which clearly disclose the obvious impossibility of affecting any plan of reorganization. An example of this is *Arey & Russell Lumber Co. v. American National Bank & Trust Co. of Danville, Virginia,* 4 Cir., 201 F. 2d 508 (1953), relied upon by Petitioner.

Wachovia also contends:

3. The Plan Approved by the Courts Below Adversely Affect the Rights of the Senior Majority Creditor.

Under Point No. 3 in Wachovia's Petition for Writ of Certiorari, there are set forth three separate areas in which it contends its rights are adversely affected. These are:

(a) Wachovia's short-term loan is converted into a different obligation,

(b) Failure to pay Wachovia the principal arrearage, and

(c) It is required to return Debtor's commitment fee.

Each of these contentions was carefully considered and rejected by both the trial court and the appellate court in its opinion (A-4, 5, and 6).

In support of these contentions, Wachovia complains that the proposed plan attempts to rewrite the commitments and agreements between the parties by providing for payment

to Wachovia the full amount of its loan in installment payments rather than payment in full which it anticipated receiving from Aetna upon completion of the 80-unit project. Debtor's obligation is evidenced by a promissory note, *payable by its terms to Wachovia in 240 monthly installments.* This note is secured by an insured first lien deed of trust to Wachovia, with its Vice President, **Archie Walker,** designated as Trustee therein.

Findings of Fact Nos. 74 through 79, inclusive (A-35-36) reflect clearly Wachovia's disregard of the requirement that it tender the loan to Aetna. The contentions of Wachovia must be considered not only in the light of its failure to tender the loan to Aetna, but with attention directed as to the reasons why such tender was not made.

The first opinion of the Court of Appeals affirming the denial of Wachovia's Motion to Dismiss *(Wachovia Bank and Trust Company v. Dameron, Trustee, supra),* succinctly stated the problem as follows:

> "The principal difficulty confronting the debtor is its inability to pay or settle construction claims in the approximate amount of $52,000.00." (Possibly reduced to $28,000/$39,000 as indicated in the footnote), "these claims caused exceptions in the title policy and prevented debtor from giving a first lien on the chattels. While Aetna's commitment was conditioned upon the debtor's payment of all construction costs, Aetna had the option to waive this requirement. The Referee found that Wachovia, however, did not offer the note to Aetna to determine whether it would accept or reject the loan, but instead, without justification, unilaterally called the note and ordered the foreclosure sale."

In its brief, Wachovia attempts to brush aside the estab-

lished fact that *after* the apartment project was completed in accordance with the plans and specifications and substantially 100% occupied (F.F. 54, A-29), and prior to Wachovia's unilateral declaration of alleged default and attempted foreclosure that it made no effort to tender the loan to its correspondent Aetna for purchase. Aetna's obligation to purchase was contingent upon certain enumerated provisions set forth in the "Buy and Sell Agreement," with a proviso that: *"Aetna shall have the option to make said purchase even though less than all of the conditions hereinafter provided shall have been met."* (F.F. Nos. 65, 76, 77, and 78, A-32, and 35, 36).

The very nature of Wachovia's loan commitment to Debtor plays an important part in weighing the equities of the proposed plan and in part answers the argument presented by Wachovia. Debtor corporation was capitalized with $400.00 of issued stock and this fact was known to Wachovia at the time its commitment was made. The sole financial requirement imposed by Wachovia was that the borrower provide $21,000.00 to cover (1) a down payment of $12,000.00 to be made to Kavanagh-Smith & Company as part of the $45,000.00 purchase price for the land upon which the project was to be constructed (the balance of $33,000.00 to be evidenced by Debtor's promissory note, payable in monthly installments of $482.10 for a period of seven years), (2) payment of a commitment fee of $6,400.00, and (3) payment of title insurance premium of approximately $1,800.00. The $21,000.00 was provided by Debtor's stockholder as a loan to the corporation. Under the proposed Plan, this loan is extinguished and treated as a capital contribution to Debtor corporation.

All parties were fully aware that the estimated cost of Debtor's project would consume virtually the full amount of the loan, and it is reasonable to assume that except for

delays incurred when the major supplier of Debtor went bankrupt, the project would have been completed with the loan funds. It was evident from the beginning that the commitment of Wachovia and Aetna was for all practical purposes a 100% loan.

By reason of the substantial amount of its loan, coupled with the increase in interest rates occurring during the period of construction (May 1966-May 1967) (F.F. No. 64, A-32), Wachovia virtually precluded any refinancing of its loan.

The thrust of Wachovia's contentions relate to the unpaid claims for material and labor remaining after completion of the project. The existence of these claims (at the time amounting to less than $50,000.00) was assigned as Wachovia's reason for declaring the loan in default and as the principal basis of its decision not to tender the loan to Aetna.

Yet, notwithstanding the marginal nature of Wachovia's loan, Debtor corporation completed its project and subsequent events have proven its ability to amortize all secured creditors without difficulty. Every monthly payment due the second lien secured creditor, Kavanagh-Smith & Company, has been made in accordance with its note. The proposed plan provides for a continuation of these payments in exact accordance with the terms of the note. Strangely, Kavanagh-Smith & Company has filed its objection to the plan. Perhaps, this is to some extent explained by the fact that in July 1967, Debtor obtained an additional $50,000.00 loan to be secured by a second lien deed of trust (F.F. No. 52, A-28). These funds were available to pay off in full all unsecured creditors. At the eleventh hour, Kavanagh-Smith & Company, holders of a second lien purchase money deed of trust, declined to agree to subordinate its relatively small

lien to the new loan. As a result, the $50,000.00 loan was not closed. Shortly thereafter, Wachovia undertook to foreclose its deed of trust. Finding of Fact No. 70 (A-34) now again becomes significant. Debtor was precluded from paying off its unsecured creditors and avoiding the attempted foreclosure by the very Company which had been holding discussions with Wachovia relating to a proposal to purchase Debtor's property from Wachovia upon the foreclosure!

During the course of construction (which commenced in May, 1966), at monthly intervals, disbursements were made by Wachovia based on a schedule of work completed and unpaid obligations arising therefrom, each schedule approved by the architect. At the time of each such disbursement, an inspection was made of the job site and the progress of construction by an official of Wachovia. (F.F. No. 38, A-24). After completion of four of the five 16-unit buildings, in April, 1967, and *before Wachovia or Aetna were aware that the balance of undisbursed funds would not* be sufficient to pay all costs of construction, Debtor was advised Wachovia did not intend to "close" the loan by assigning it to Aetna (F.F. No. 41, A-25), and that it should seek a new loan from an independent source. As stated above, the amount of Wachovia's loan, together with the substantial increase in interest rates, prohibited Debtor from pursuing this course of action, particularly with the further increase in interest rates thereafter to 9½%-10% in December, 1969 (F.F. No. 64, A-32).

Both the Special Master and District Judge considered Wachovia's numerous contentions that its loan was in default when it refused to accept the installment payment tendered by Debtor on July 1, 1967. Both determined that no default existed which justified the attempt by Wachovia to demand payment in full of Debtor's obligation (F.F. Nos. 46, 47, 48, 49, 51, and 53, A-27-28).

The title insurance policy insured Wachovia's deed of trust as a first lien on Debtor's apartment project (F.F. No. 53, A-28-29). No condition has ever existed which has impaired the effect of this policy, since the deed of trust has been, since its recordation, and still is, a first lien deed of trust. Wachovia's officer, Archie Walker, (and also trustee in its deed of trust) was president of the company acting as broker for the company issuing the title policy and as such made his own determination as to requirements and conditions in respect to said policy (F.F. No. 68, A-33). This created an obvious conflict of interest.

Lastly, when foreclosure was undertaken by Wachovia, it was precipitated by this same officer (Walker) who was the Trustee in its deed of trust and a vice president of Wachovia as well. Since the decision of the North Carolina Supreme Court in *Mills v. Building and Loan Association*, 216 N.C. 664, 6 S.E. 2d 549, lending institutions have designated substitute trustees for their own officers to insure impartiality in the performance of the duties imposed upon the trustee. Under the circumstances of this case (with Kavanagh-Smith & Company's interest in purchasing Debtor's property), Wachovia's undertaking to foreclosure, with its Vice President acting as Trustee, is subject to careful judicial scrutiny.

Wachovia's contentions under POINT 3 of its argument, in view of the facts disclosed by the record before this Court, are without substance.

Wachovia finally contends:

4. **District Court and Circuit Court Misconstrued the Role of the District Judge in Passing Upon Plan of Reorganization Under Chapter X.**

United States District Judge Eugene A. Gordon was thoroughly familiar with the facts of this case by reason of

his prior ruling on Wachovia's Motion to Dismiss. In that instance he specifically held that certain Findings of Fact were not supported by the record and not adopted by the Court. Subsequently, careful and detailed attention to this matter was made by Judge Gordon in respect to the hearing held to determine whether the proposed Plan of the Successor Trustee should be approved.

On November 9, 1970, the parties were afforded opportunity to and did present oral argument to the Court. Wachovia and Respondent were each directed to present to the Court proposed Findings of Fact and Conclusions of Law. This was done.

In preparing his order approving the proposed Plan, Judge Gordon again demonstrated the detailed attention given to his consideration of the proposed Plan. His order recites, in part:

> "After hearing oral arguments and considering the official file, including *transcripts, exhibits,* and briefs, it is determined that the *findings of fact* and *conclusions of law* of the Referee are neither arbitrary nor clearly erroneous, and the Court adopts the same for the purpose of approving the Plan of Reorganization submitted by the Trustee."

There was nothing "perfunctory" or "offhand" in the Court's approval of the Plan. Counsel for Wachovia had ample opportunity to (and did) augment its written objections by oral argument. The hearing was held on November 9, 1970. All proposed findings and briefs were filed by December 21, 1971. More than two months later, Judge Gordon rendered his decision. There is no doubt that the entire matter received the "informed, independent judgment" of the Court. To infer otherwise is a reflection on the

conscientious Judge who obviously gave this matter careful attention before arriving at his decision.

Respondent contends:

The Decision of the Court of Appeals is Correct.

Petitioner attacks the decision of the Court of Appeals as being predicated upon an erroneous application of the law to the facts as found by the trial court. The decision below demonstrates a careful, in depth, analysis of unique facts of this case and the application of the pertinent provisions of Chapter X to these facts. In the last analysis, the bankruptcy court is vested with broad equitable powers. While the Act does impose certain limitations upon the exercise of these equitable powers, the flexibility granted to the Court in approving a plan is clearly evidenced by the language of Section 216(7)(d) set forth above. There is nothing in the decision of the Court of Appeals to indicate that the approval of the plan submitted by the Trustee in this case transcends the proper exercise of proper judicial authority.

As stated in Collier on Bankruptcy, Vol. 6A, Sec. 10.02, pp. 416-418:

> "A plan of reorganization, and indeed the whole reorganization process envisions the maintenance of the going-concern values of the debtor . . . . It does mean that the business enterprise involved will, if possible, be refurbished in some fashion so that it may continue to operate as a sound commercial and economic unit. The devastating and final effect of foreclosure or ordinary bankruptcy, with the attendant loss of values through forced sales and the rigid and inflexible procedure afforded, is thereby avoided."

The action of both the Special Master, the District Court, and the Court of Appeals in approving the Plan of Reorganization finds ample support when attention is directed

to how the Plan affects Wachovia. A firm commitment was made by Wachovia in 1966 to lend Debtor $640,000.00, with interest at the rate of six per cent (6%) repayable in twenty (20) years, in monthly installments of $4,586.67, commencing April 1, 1967 (extended by agreement to July 1, 1967). As security for repayment of the loan, Wachovia obtained from Debtor a first lien deed of trust on Debtor's 80-unit apartment project. Thereafter, the apartment project was completed in accordance with the plans and specifications therefor and within the period specified by Wachovia. Under the proposed plan, Wachovia remains the holder of the first lien deed of trust (recorded May 13, 1966) which it has always possessed, with no impairment of its position as a first lien creditor. Notwithstanding its operation under a trusteeship, the apartment complex has been successful with a high percentage of occupancy over the past four years. Without difficulty, the Trustee has made continuous successive monthly payments of $4,586.67 to Wachovia since October 1, 1967. A continuation of these payments as provided by the plan will pay back to Wachovia with all interest, within the twenty-year period commencing on July 1, 1967, all but $891.21 of the funds loaned to Debtor (a total of $632,726.45 having been loaned). Provision for payment of this sum within the twenty-year period is required by the Plan. Simply, and in its essence, the Plan provides for the same security and repayment as initially contemplated.

CONCLUSION

For the reasons above set forth, Respondent respectfully requests this Court for the entry of an order denying the Petition for a Writ of Certiorari.

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